U.S. TRADE POLICY
Phase II: Private Sector

HEARINGS
BEFORE THE
SUBCOMMITTEE ON TRADE
OF THE
COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES
NINETY-SEVENTH CONGRESS
SECOND SESSION

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U.S. TRADE POLICY

MONDAY, FEBRUARY 1, 1982

House of Representatives,
Committee on Ways and Means,
Subcommittee on Trade,
Washington, D.C.

The subcommittee met at 9:35 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Sam M. Gibbons (chairman of the subcommittee) presiding.

Chairman Gibbons. Good morning, ladies and gentlemen. We are continuing our trade oversight hearings. As you know, we have already heard from the administration. We have heard from a part of the private sector. We want to hear from all the private sector. In fact, if they do not all come in voluntarily, we may request that some of them come in, because we want to make sure that everyone gets heard in this oversight hearing. We will continue today and try to finish up by noontime. We will then start again tomorrow and try to finish by noontime, and then we will announce later hearings after that.

[Mr. Gibbons' opening statement follows:]

Opening Statement of Hon. Sam Gibbons, Chairman, Subcommittee on Trade, Oversight Hearings on U.S. Trade Policy

Good morning. The subcommittee will come to order.

This morning the Subcommittee on Trade is continuing the private sector phase of major oversight hearings on all aspects of U.S. trade policy—how it is made, and implemented, administration of our trade laws, and the trade problems and issues we need to deal with in the 1980's.

We will also hold the hearings tomorrow morning and then complete testimony from remaining private sector witnesses, who had requested to appear, on a third day to be announced as soon as the subcommittee schedule permits. We will also be calling administration officials back to comment on private sector views and suggestions. In the meantime, the hearing record will remain open for written submissions.

We ask witnesses to summarize your oral testimony on the understanding that your full statements will appear in the hearing record.

Our first witness this morning is Rudy Oswald, director, Department of Economic Research of the AFL-CIO. Mr. Oswald, we appreciate your willingness to appear before us again in these hearings to answer questions from the members on the testimony you presented to us in December. Again, I apologize that we were unable to complete your appearance at that time. To refresh our memories, would you mind summarizing for us your major points?

[Press release follows:]

[Press Release of Jan. 26, 1982]

HON. SAM M. GIBBONS, CHAIRMAN, SUBCOMMITTEE ON TRADE, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES CONTINUATION OF PRIVATE SECTOR PHASE OF OVERSIGHT HEARINGS ON U.S. TRADE POLICY

The Honorable Sam M. Gibbons, (D-Fla.), Chairman of the Subcommittee on Trade of the Committee on Ways and Means, U.S. House of Representatives, today announced that the private sector phase of oversight hearings on U.S. trade policy begun last month (previously announced in press releases #10, #11, #12, #13, and #15) will continue on Monday and Tuesday, February 1 and 2, 1982. The hearing will be held both days in the Committee on Ways and Means main hearing room, 1100 Longworth House Office Building, beginning at 9:30 a.m.

The schedule of witnesses will be available on Friday, January 29.

Further dates for completion of the hearings will be announced as soon as the Committee's schedule permits.

Chairman GIBBONS. Our first witness this morning is Mr. Rudy Oswald, the director of the Department of Economic Research of the American Federation of Labor and Congress of Industrial Organizations.

Mr. Oswald, the last time you were here we unfortunately had a lot of interruptions and did not get an opportunity to hear you, and so I want to take this time to welcome both of you back and be prepared to listen as long as you want to talk.

STATEMENT OF RUDY OSWALD, DIRECTOR, DEPARTMENT OF ECONOMIC RESEARCH, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS, ACCOMPANIED BY ELIZABETH JAGER, ECONOMIST

Mr. OSWALD. Thank you, Mr. Chairman.

My name is Rudy Oswald, director of the Department of Research for AFL-CIO. Accompanying me is Elizabeth Jager, an economist for the AFL-CIO. My testimony has been submitted.

Since that submission in December, there are a few things that I would like to highlight in terms of what I think has been a worsening of the economic situation. Clearly the recession has gotten substantially worse. There is a clear indication that we will be in a deep, long recession. Since last July, 750,000 workers have lost their jobs in manufacturing. During this period, imports continued to flood into this country, taking more and more of a reduced level of demand in this country.

We believe that during a recessionary period such as we currently have that there must be quick action to share the downturn among all, not just among American workers, but among others throughout the world, so that the imports themselves are limited to the same proportion of total sales that they had before the downturn. Without such an adjustment mechanism, it means that the full brunt of the recession is borne only by American workers and not by those who would flood our markets with the goods from overseas at a period that the country is already reeling under the severe impacts of recession.

We believe that there should be a quick mechanism during recessionary periods that would limit the imports that come in. We believe that there is mechanism within the act, section 201, that talks about not only the injuries that come from imports, but the threat of such injury. Clearly during a recession you have both the injury plus continued threat.

The other item that I would just emphasize that has changed is that the figures for the year in terms of the trade deficit are complete. They have now increased from a $36 billion deficit in 1980 to a $40 billion deficit in 1981, indicating that we clearly are at a severe disadvantage in terms of our flow of trade.

The third item that I would like to emphasize, and I think it is often highlighted by some of the newspapers today, is the interaction of some of our monetary policy with the trade impact. Clearly in the past year the impact of the Federal Reserve following its tight monetary policy has raised the value of the U.S. dollar by approximately 25 percent against major currencies around the world. So that in terms of imports, they are currently 25 percent cheaper than they were a year ago, our exports 25 percent more expensive.

There has been considerable discussion in the newspapers about the need for American workers to somehow make adjustments in their wages because of the trade impact. Well, it is almost impossible to say to workers that they should take a 25-percent cut in their wages because the Federal Reserve Board follows the type of monetary policy which makes the dollar 25 percent appreciated against other major currencies. I think it is important that we direct the Federal Reserve Board to follow a policy that does not have such a differential impact upon workers and upon trade and the value of the dollar and that sort of an impact. Clearly if the Japanese automobiles were 25 percent more expensive, they would not be selling in this country at the same level that they are.

So that there are a number of interacting effects that I think often we do not take fully into account. That is that, first of all, we talk of free trade, but everybody else talks about their own best advantage. I think it is important that we talk about fair trade rather than free trade. We need some reciprocity in terms of our actions. We must deal with some of the problems that happen to us in terms of the nonmarket activities of the East and other nonmarket countries in terms of our trading. But most of all we quickly must enforce the trade laws that are on the books. The notion that the steel industry in this country, when it is harmed, should have to wait 18 months before it can get a decision on a subsidy arrangement that occurs in Europe and many other countries where there is broad recognition thereof is a problem. In a sense we have justice delayed, which we believe in many cases, is justice denied.

Of course, we are still very concerned that the last session of the Congress for all practical purposes did away with trade adjustment assistance, which had been promised but was hurt by imports. We feel that that is a serious problem for American workers.

The only other comment I would like to make, Mr. Chairman, at this point is in terms of one of the issues that you are currently marking up. That is to provide the President extended ability to negotiate further tariff reductions. We believe that that extension should not be given at this time because of the extensive tariff cuts that have already been negotiated and will take place over the next 8 years under the MTN negotiations. We believe that there are disastrous results from individual tariff reductions at this stage after such major changes as took place in the MTN.

Thank you, Mr. Chairman, for allowing us to reiterate some of our major concerns on these issues.

Chairman GIBBONS. Thank you, Mr. Oswald.

[The prepared statement follows:]

STATEMENT OF RUDY OSWALD, DIRECTOR, DEPARTMENT OF ECONOMIC RESEARCH, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

The AFL-CIO believes the United States needs a trade policy that is fair. Trade today consists of about $500 billion worth of merchandise imports and exports combined. Trade affects jobs, technology and the nation's future.

The nation is now in a serious recession. Already 9 million Americans are jobless. Plant shutdowns are not a sign of Christmas holidays, but rather of a national tragedy.

Compounding and worsening that tragedy is the adverse trade relationship. During the first 9 months of this year, the nation's trade balance has run $26.2 billion in the red.

IMMEDIATE ACTION NEEDED

Instead of the current preoccupation with the nation's budget deficit—money we owe ourselves—there should be more concern about the trade deficit—obligations this nation must meet to producers abroad.

It is time to recognize the signs that imports are aggravating the effects of the recession, particularly in basic industries.

The recession needs many national actions to turn it around and put the nation on a solid expansion path. One of those actions must deal with the additional impact of imports upon industries reeling from the blows of recession. Imports—now over 30 percent of the production of all goods in the U.S.—must be regulated until U.S. industry can get back on its feet. Otherwise, the plant closings will be permanent and the U.S. will emerge from the recession with even less of an industrial base.

For this reason, the AFL-CIO has called for action on trade as part of a much larger national recovery program. The recent AFL-CIO convention adopted a program calling for import restraints on harmful imports as part of a total package of necessary steps. This import policy should be part of a temporary national emergency program. (See attached statement, Appendix A.)

The law already recognizes that import injury or the threat of injury should receive temporary action. During a recession the effective enforcement of such laws is all the more urgent.

THE LONG TERM TREND

The public explanations for trade policy have come full circle since World War II. Then, as U.S. seamen watched the shipping industry go down and their jobs exported to foreign flags, they were told that the U.S. is a manufacturing nation—not a service nation.

Exports of manufactures are job creators, the story went. But in the three decades since that war, the deficits have grown in basic industries: steel, autos, textiles, electronics, shoes, some types of machinery. Each time the newer technology industries were considered to be an answer. But they no longer are an answer as even aircraft and computers are now using imported parts.

Now the story has turned in 1981 as the international trade balance shifted from surplus in the 1960s to deficits in the 1970s and 1980s. Now the emphasis is on service industries in trade policy, because the U.S. is a service economy.

However, the AFL-CIO believes the United States must be a diversified manufacturing, agricultural and service economy. We need high technology industries and many other industries for full employment. Trade is part of that goal. The U.S. should trade to live—not live to trade.

The Council of Economic Advisers still portrays all people who are concerned about import damage as "special interests." The AFL-CIO believes this is a false view of the special interests in trade policy.

Importers, foreign investors or foreign governments are all special interests. On the other hand, the jobs and production that imports cost across the nation are a general problem that should be considered in the national interest. The people who pay the costs of imports now number in the millions. Surely it is time to recognize the costs as well as the benefits involved.

The AFL-CIO believes in fair trade. Instead, the government abdicates responsibility except to try to talk other countries into greater markets for U.S. exports. That is a valid and important goal, but it is only part of the picture and part of the goal. The continued encouragement of products from nations which don't give America a fair deal is a bankrupt policy. The negotiators have no leverage under such policy.

The President of the AFL-CIO asked for a fair trade policy last summer. He made these main points:

A fair U.S. trade policy would:

Provide a full account of what happens in the real world, a world where free trade does not exist. Other nations in the world do not apologize for pursuing their national interest. Yet the U.S. is under constant assault when suggestions are made to move in U.S. national interests.

Enforce U.S. laws and international agreements against unfair trade practices so as to allow U.S. producers and workers a chance to improve industries impacted by trade. Procedures that now inhibit appropriate responses should be simplified.

Monitor imports and exports and their impact on the U.S. economy. Such detailed monitoring is required now, but it does not exist. Without such monitoring, industries and workers now injured by imports are not able to make their case and solutions are not provided.

Achieve reciprocity. Where other nations bar U.S. products through one means or another, the opportunity to enforce U.S. laws to gain access should be encouraged to even out the burdens in the world. Equivalent access to foreign markets is key.

End the incentives U.S. firms now have to invest abroad in order to take advantage of multibillion dollar tax subsidies and insurance for overseas investment. Firms that go abroad for cheaper labor should not be given subsidies to do so. These subsidies and pressures for expansion or relocation abroad should be repealed.

Repeal counterproductive laws. For example, the U.S. now grants zero tariffs or preferences for imports of more then 2700 products from 140 nations and territories. These special privileges called the Generalized System of Preferences (GSP), do not aid the neediest people abroad, and the imports injure U.S. industries and jobs. This Generalized System of Preferences should be repealed. At a bare minimum, Congress and the Administration should remove import-sensitive products from the list, guarantee that only the neediest countries receive the benefits, and exclude communist economies.

Establish national security policy goals that provide not only an adequate defense but also a fully-employed, strong economy. Only a strong United States that has the means to feed, house, clothe and transport its population can provide adequate national security.

Provide realistic adjustment assistance for those injured by trade. The cost to the nation of losing its pool of skills is severe. Millions of Americans have lost their jobs through no fault of their own as a result of trade policies. Lost jobs, devastated communities and eroded tax bases dot the U.S. landscape. Yet these losses are not even measured, much less corrected.

These policies are part and parcel of the recent AFL-CIO policy statement adopted at the AFL-CIO Convention in November. (See Appendix B.)

This is still an appropriate set of guidelines.

REAL WORLD REPORTING IS OVERDUE

This is not a world of free trade with a "world market" out there for any U.S. entrepreneur to sell exports if only he tried hard enough. This is a world in which most nations have protected their markets and pursued what they view as their national interest. They do not apologize for it. Japan limits U.S. exports in virtually all manufactured products—autos, steel, computers, film, leather, tobacco, and many agricultural products—beef, citrus, etc.—either by law, practice or their distribution system.

In the U.S. it is considered "protectionist" even to try to enforce the law and codes on dumping. But the rest of the world has made agreements and enforced rules to make sure their industries survive. That is not fair to the industries and jobs of the U.S.

In the real world, there is a set of markets and governments are important determinants of how trade flows. Free trade does not exist.

Most nations of the world have domestic content requirements either in policy or law or practice. They require or force companies to produce within their national borders at least a certain percentage of a product—a car, for example—within their borders in order to sell there. Or they have so many ways of interfering with imports—inspections, technical standards, special marketing methods that their own products dominate their markets.

The United States needs to have a domestic content law for autos right now or this country will become an assembler of foreign made parts.

Assistant Secretary of State, Robert Hormats, recently described the 1977 Mexican auto decree as follows: The 1977 Mexican auto decree requires a producer to obtain the foreign exchange requirements needed for their operation (e.g. for imported components and indirect foreign exchange costs such as interest and dividend payment made abroad) through the export of completed vehicles and parts, and allocates foreign exchange among the producers on the basis of, inter alia, the percentage of domestic materials incorporated in their products.

Mexico is not in the GATT, so the GATT rules do not apply. The fact is, that action needs to be taken by the U.S. under its own law—not to be hostile to Mexico, but to make sure that the U.S. auto and parts industry thrives. That is a governmental obligation.

But these national actions by all other nations are virtually overlooked or become the subject of efforts toward future negotiations for international agreements. The AFL-CIO believes that there must be action now or the long-run will see a United States without industrial strength.

U.S. LAW ENFORCEMENT IS LAX AND INTERNATIONAL AGREEMENTS ARE NOT ENFORCED FOR U.S. INTERESTS

Attempts to carry out international agreements or other pursuit of U.S. rights are regarded as protectionism—but little attention is paid to actions of other nations against the U.S.

Enforcement of existing laws—and improvements where they are failing—is therefore a first step toward fair trade.

The GATT and U.S. law allow temporary action when injury to U.S. industry occurs.

Now the auto workers and many other U.S. unions have petitioned for relief from auto imports—injury that is obvious. The law designed to provide time for the industry to become competitive is Section 201 of the Trade Act of 1974—and the "escape clause" of the General Agreement on Tariffs and Trade (GATT). Thus the case was not a violation of any agreement or law. But the result was no action by the U.S. government. Two Presidents told the Japanese there would be no restraints by the U.S. government. The Japanese when finally convinced that some action had to be taken, put modest restraints on their exports. But U.S. producers of auto parts have received no help at all for their special problems.

No injured industry has ever achieved the relief it sought under Section 201. Since the 1974 Trade Act was passed, only 9 of 45 cases have received any restraint on imports. The ITC usually recommends less than industry seeks—be it quotas or tariffs or tariff quotas—and the President either ignores the ITC recommendation altogether or grants less than it calls for.

Specialty steel, color TV and shoes are examples of the industries where relief has been phased out or phased down. Industrial fasteners—nuts, bolts and screws—receive minimal relief and are currently seeking an extension of that minimal relief.

These are just a few examples of major industries that are affected. Small producers of parts essential to these industries usually get no relief at all.

Under current procedures, the cost, the data requirements and the complex legalisms are so difficult to overcome that injured industries and groups of workers cannot afford to bring actions for relief from inrushes of imports or dumping. This is not fair trade policy. This policy of inaction leads to more unfair trade. The law should be enforced, improved and emergency procedures established to prevent the outrush of key industries.

Subsidies, dumping and other unfair trade practices, condemned in law—both nationally and internationally—have received relatively little effective action. Even when injury is proven and violation of laws and agreements is well known, only occasional limited actions have been taken.

For example, steel has been subsidized and dumped in the U.S. market for a long time. But neither the U.S. law on dumping nor the international agreement has been widely enforced. A "trigger price mechanism" to get the steel industry to withdraw its dumping suits was established and was helpful for a time. But the massive losses of American steel production continue. Fabricated steel is not even effectively monitored, so that loss is uncounted. But when steelmakers talk about filing legal actions against unfair trade, the roar against "protectionism" is deafening.

A U.S. petition for dumping action on imported TV sets received a positive finding in the late 1960's. However, legal suits continued until June 1981 when the ITC ruled against the Japanese attempt to reverse earlier decisions. These U.S. actions were too little, too late, and in the meantime, the industry has been eroded.

A RENEGOTIATED MULTIFIBRE ARRANGEMENT IS NECESSARY

Textiles and apparel receive some help, but the barrage of complaints about this industry leads to a distortion of the size and importance of that help. It is unfair to expect the U.S. to continue to destroy its domestic textile and apparel industry and to charge the U.S. with protectionism in a protected world.

An international textile agreement—the Multifibre Arrangement—regulates this trade. It should be renegotiated to provide for orderly sharing of the U.S. market growth in the U.S. This is fair under international rules.

EQUIVALENCY OF ACCESS

But reciprocity—equivalency of access to markets—is a fair trade concept that the U.S. policymakers have too long overlooked. Thus a U.S. exporter does not have equivalent access to the markets of Japan, or Brazil or Romania or the Soviet Union or most countries in the world. But the cry of protectionism is not leveled against these foreign governments. The outcry is against the U.S. producers who complain. If all the U.S. government does is ask for access and never takes action at home, the foreign negotiators will win our markets and the U.S. will continue to lose its industries.

Some of the newest U.S. industries, like semi-conductors and computers and aerospace, are good examples of U.S. industries that will soon be lost because our trade policy does not enforce reciprocity. Instead, the industries can go to other nations, be protected within those markets and export to the United States or third markets. U.S. policy, which tried to avoid any help to American producers in the U.S., supports subsidies to the investors abroad in most nations of the world. This is not fair.

TRADE ADJUSTMENT ASSISTANCE

The AFL-CIO believes that the United States needs an improved trade adjustment assistance program for workers injured by imports. Experience for the past 20 years underscores the urgency of improving benefits for those who lose their jobs from this cause. The Omnibus Budget Reconciliation Act of 1981 virtually abolished the trade adjustment program. The paltry sum now available in the budget—a cut from $1.5 billion to $317 million—amounts to another broken promise to those who pay the price of trade liberalization.

The cost is now being paid across the nation. Yet the Administration and the Congress have not provided even the paltry $112 million promised for training.

EXPORT POLICY

Export promotion should be a government priority. Exports of farm products, manufactured products and raw materials are important. AFL-CIO members work on farms and in factories and in offices and in services. They produce some of the world's most sophisticated, as well as some of the older, industrial products for exports.

However, export policy is not the answer in a world where equivalency of access does not exist. Export promotion should be targeted for specific goals and should not include capital, technology and price sensitive commodities. Export promotion should emphasize processed agricultural products.

To reduce inflation in food, it is important to restrict the export of commodities in short supply. The world trade in grain has become so complex that the AFL-CIO believes a National Grain Board, similar to the Canadian Wheat Board, should handle foreign sales of U.S. grain. While we wish to encourage the export of coal and other materials, policy should be flexible enough to assure adequate energy supplies at home.

Export promotion should neither get priority over domestic budget needs nor be used as an excuse for blanket changes in U.S. antitrust or banking laws.

Stopping the incentives in our tax and trade laws for foreign expansion by U.S. firms and banks would help the United States to achieve both better trading arrangements and a better economy at home.

The principal traders of the world are now multinational banks, firms and governments who are often their partners. Some governments are multinational entities. The governments of many countries—both communist and non-communist—have become huge multinationals. Developing countries now spawn multinationals of their own. Most multinationals are no longer U.S.-based, but the U.S.-based multinationals still dominate U.S. trade. The tax and trade laws made this possible.

The multibillion dollar tax subsidies available for U.S.-based firms' operations, such as the Domestic International Sales Corporation, foreign tax credits and the deferral of taxes on overseas profits are in direct conflict with national needs, such as the availability of capital at home. No longer can they be justified as promoters of exports. They should be repealed.

The Overseas Private Investment Corporation should also be ended, since it encourages U.S. firms to invest abroad by insuring such investment against political risk. That is a subsidy of the export of U.S. technology.

For foreign multinationals in the United States, the AFL-CIO has urged adequate reporting. The AFL-CIO has also opposed raids or unscrupulous takeovers, and has called attention to the need to prevent takeovers in strategic industries. In addition, the current influx of investments has led to many abuses and avoidance of U.S. labor laws. The AFL-CIO has consistently warned that U.S. laws and international codes on labor should be enforced.

NONMARKET TRADE

The impact on U.S. trade of barter arrangements can be large. Pricing policies of the firms using barter and/or of a communist country are not based on product cost as in a market system. Countertrade is a serious danger because of the continued transfer of technology and the loss of production and jobs. Yet countertrade may represent 20 percent of world trade in the 1980s.

Critical U.S. military technologies have been handed over to nations committed to support the Soviet Union as part of a massive pattern of transferring U.S. technology around the world.

The AFL-CIO has long urged adequate monitoring of non-market trade and bilateral regulation.

SERVICES

Services represent a huge combination of issues too long overlooked in trade policy. For U.S. banks, shipping companies, airlines, broadcasting, advertising, insurance and many other types of firms, the policy issues seem clear: discrimination against their foreign expansion calls for action by the U.S. government.

For many years, AFL-CIO policies have also called attention to effects at home. Seven out of ten U.S. jobs are now in "services." American seamen were the first to experience the export of service jobs after World War II, as we noted earlier in this statement. American air traffic has led to disputes that affect pilots, flight attendants and maintenance crews. The AFL-CIO does not want to see jobs in services—now the majority of jobs in the U.S.—traded away as manufacturing jobs have been.

In the new world of services, definitions are needed. The balance of payments accounting lists "services" or "invisibles" to include current payments for virtually everything except merchandise and long-term capital flows. Such a massive bundle of industries and problems is a tall order for the world's negotiators.

The AFL-CIO believes that policies on services should be carefully developed on a case-by-case basis to solve specific situations. Action to solve these specific cases should be undertaken on a bilateral basis. Long-term policy goals for multilateral negotiations should not get in the way of solutions for present services problems.

INVESTMENT POLICIES

The long term trends indicate that investment abroad has grown so much that the policies to expand it are obsolete.

Services are therefore intertwined with the massive increases of total U.S. international capital flows. These rose 800 percent between 1970 and 1980 and dwarf the 164.5 percent increase in the nation's gross national product. These capital movements are highly volatile and interfere with domestic economic stability.

Flows of U.S. direct investment abroad were $7.6 billion in 1970 and $24 billion in 1979—an increase of over 200 percent. In comparison, fixed nonresidential investment in the U.S. rose only 169 percent during this period.

While it remains at lower levels, foreign direct investment in the U.S. has increased at even a faster rate than U.S. investment abroad. Between 1970 and 1980, annual foreign direct investment in the U.S. rose more than seven-fold, from $1.4 billion to $10.9 billion.

Floating exchange rates have weakened U.S. trading relationships by causing unnecessary fluctuation in expectations, unsettling markets, adding to investment abroad and leading to more inflation at home. They have encouraged high interest policies at home that to a large degree "manage the float."

The policy of using high interest rates to curb inflation at home has a double impact on the U.S. Such rates hurt U.S. investment and also hurt chances for improvement of industries adversely impacted by imports. In 1981, the U.S. automobile industry had its lowest sales in over 20 years and tight money as well as imports were the major cause.

High interest rates attract short-run, unstable capital from abroad. The dependence on high-interest, restrictive monetary policy weakens the U.S. and hurts the ability of the traders to improve the domestic economy.

Thus the AFL-CIO priority in attacking inflation is to attack its main underlying factors—high interest rates, too much dependence on imported oil, obsolete productive capacity, poor income distribution and unemployment. The maintenance of high interest rates to attract massive capital inflows is doubly self-defeating.

The AFL-CIO has jointed trade unions in Western Europe and other industrial countries in urging our governments to seek steps to promote full employment, price stability, investment and adequate growth while coping with energy needs and technological change.

The AFL-CIO believes that more realistic and effective U.S. policies should lead to a greater cooperation with other countries for more efficient and effective trading systems for mutual benefit.

Foreign policy will always affect this nation's policies on trade. But successful foreign policy requires that the U.S. maintain its prowess at home and not assume that this economy can adjust to every foreign policy change with public explanations that the U.S. must have free trade or foreign countries will be injured. We believe continued failure to act to revitalize the U.S. economy will injure other economies as much as our own.

THE CARIBBEAN POLICY

Even worse, the U.S. now talks of "one-way free trade" for the Caribbean. "One-way free trade" will not attack the basic problems of that area. The AFL-CIO has long been concerned about the need to develop healthy economies in the countries of this area. But "one-way free trade" is absurd. All that it means is subsidies for U.S. investors and an export of jobs to countries where living standards and conditions are pitiably low without any guarantee that the people in those countries will truly share in the profits and benefits involved. A few thousand job exports and higher returns for U.S. investors does not represent our system. It gives a false view of how the U.S. works. The U.S. cannot afford the imbalance that now exists.

While current U.S. policy excludes Cuba because of its communist, left-wing dictatorship, we believe the same standards should be applied to Haiti where human rights are also denied.

Government participation in trade must therefore be recognized as an ongoing reality—not something to be avoided at all costs. Under the U.S. Constitution, Congress is empowered to regulate interstate and foreign commerce, to levy taxes, etc. The President conducts foreign policy. Both have a responsibility for a trade policy that helps the nation at home as well as abroad.

Instead there has been an abdication of responsibility. The major decisions have been to avoid taking necessary actions to revitalize the U.S. economy while talking about "free trade" in a world where free trade no longer has meaning.

The United States needs a fair trade policy in keeping with the world of the 1980s. International trade decisions at home must stress the U.S. need for a diversified industrial base with the skills and services of an advanced economy. Only a policy to create full employment and rising living standards at home will enable the United States to maintain its cooperative role as a leader in the world.

APPENDIX A

AFL-CIO ANTIRECESSION PROGRAM

Like a snowball rolling downhill, the economic recession is gaining momentum. Unemployment has increased by one million in the past three months and each day thousands more are being laid off.

But the Reagan Administration response to rising unemployment is to resurrect Herbert Hoover's economic policies of 50 years ago with additional budget cuts that will further weaken demand, reduce output, and destroy more jobs.

The resulting weakened economy would be even more costly and damaging to the nation in terms of lost production, lost jobs, lost skills, and lost income to producers and workers.

The tragedy of unemployment and the steadily worsening economic situation must be reversed.

The AFL-CIO calls upon the Congress to pass the following anti-recession, job-creating programs:

A. Programs already on the books must be given sufficient funding to provide jobs rapidly and help lift the economy, specifically:

Revive the emergency local public works program;

Provide new low- and middle-income housing units;

Restore public service jobs for workers not able to find jobs;

Restore nationwide extended unemployment compensation benefits to protect the long-term unemployed.

B. Stimulate the economy with new legislation, specifically;

Establish a Reconstruction Finance Corporation to revitalize the economy with loans, loan guarantees, interest rate subsidies and targeted tax benefits for retooling and growth of basic industries with special consideration for high unemployment areas;

Place temporary restrictions on harmful imports to prevent added penetration of U.S. markets by foreign producers and further weakening of the nation's industrial base.

C. Use credit control authority to offset tight money policy and excessive interest rates and to channel funds into productive uses, including housing, and to stop unproductive credit flows that aggravate the economic situation with speculative excesses and merger activities.

D. Raise revenue for these programs and restore equity by:

Limiting the individual income tax cuts for 1982 to $700 per taxpayer, roughly the amount scheduled for those with incomes of $40,000;

Cutting the 10 percent investment tax credit back to its original 7 percent level to preclude subsidizing the same firms and investments as does the huge newly enacted depreciation system;

Withdrawing oil windfall profits tax give-aways to wealthy oil royalty owners in the 1981 Reagan Tax Act.

APPENDIX B

INTERNATIONAL TRADE AND INVESTMENT

In order to achieve fair trade, international trade and investment policies must give greater emphasis to U.S. interests through its own national actions and through cooperation with other nations.

The United States must remain a major maritime, agricultural and manufacturing nation. The U.S. needs a foreign trade policy that will insure—not undercut—that goal.

The new factors in international trade require attention, while old problems also need solutions:

To assure a viable industrial base and national security, immediate import relief should be accorded some key industries faced with serious erosion, such as the auto and steel industries. Existing laws should be improved to assure speedy relief to industries when the threat of injury from imports is evident. These laws also should be amended to assure that the producers of major and essential components can receive appropriate relief from injury caused by imports.

Domestic content laws should be enacted to assure continued production of such products as autos. A U.S. production requirement is needed to preserve employment and skills and shore up the nation's sagging industrial base. Local content requirements in autos should be tied to sales volume and should be phased in beginning with the 1983 model year.

The problem of steel imports requires continued attention and negotiations to assure the success of the trigger price mechanism for basic steel, the "surge" mechanism for specialty steel and effective monitoring of fabricated steel. With imports of steel nearing 25 percent of the U.S. market stronger measures, including quotas, may be necessary. Tripartite efforts, involving industry, labor and government, can assure that technological changes and capital improvements make this industry once again a vital base of America's economic future. Plant modernization must be undertaken immediately in the current locations.

The Multifibre Arrangement for textiles and apparel should be renegotiated to provide for an orderly regulation of imports of textile/apparel market growth between imports and domestic production. A global approach toward textile and apparel imports and modifications of the MFA provisions to prevent major disruption and economic hardship in the U.S. textile/apparel industry are necessary.

Also, tens of thousands of workers in the electronic, chemical, pottery, glass, rubber, toy, shoe and other American industries, are unemployed because their jobs have been shipped overseas.

The manufacturing clause of the U.S. bottoms for cargo generated by U.S. Copyright law must be extended in order to protect widespread losses of jobs throughout the U.S. printing industry.

There should be greater use of the U.S. merchant marine fleet by the U.S. Navy for auxiliary functions. Reviving the U.S. merchant marine also requires the negotiation of bilateral shipping agreements, particularly with respect to grain and coal shipments. The U.S. government also should ratify the UN Committee on Trade and Development code for liner conferences, which would help restore more equity of shipment in U.S. bottoms for cargo generated by U.S. trade. There should be a revision in the tax incentives and budgeting regulatory practices to encourage the building of new vessels in the U.S. rather than in foreign shipyards.

The slashing of Trade Adjustment Assistance, that has resulted from the budget cuts, must be reversed. Those workers who lose their jobs because of imports should receive the 70 percent of lost pay for up to one year, and the training and relocation aid that they were promised in the Trade Acts of 1974 and 1979.

Trade issues in "services" should be approached on a case-by-case basis and in bilateral negotiations. A clear and appropriate definition of services and adequate statistics need to be developed before multilateral trade negotiations are undertaken. The U.S. government should help promote the rights of American services industries abroad where unfair barriers stand in the way of increased U.S. employment. Service industries in the U.S. should be analyzed in relation to employment effects before there are any overall negotiations. U.S. service workers and firms should have protection against unfair trade practices.

The Generalized System of Preferences should be repealed. At a bare minimum, Congress and the Administration should remove import-sensitive products from the list, guarantee that only the neediest countries receive the benefits, and exclude communist economies.

Foreign trade zones in the U.S. should be limited and strictly monitored so that they do not become a means of circumventing U.S. trade laws or undercutting U.S. industries' growth.

Items 807 and 806.30 of the tariff schedules reduce tariffs on products containing parts produced in the U.S. These provisions export American jobs and should be repealed.

The U.S. should establish an oil import agency to purchase and distribute oil imports, thus assuring the nation an adequate supply of oil at a fair price.

Grains and grain agreements should assure export of food products made from grain as well as the grain itself. The U.S. government should be the negotiator, through an established "Wheat Board" similar to the Canadian model.

Export promotion should be a government priority, carefully targeted to accomplish specific goals. It should not include capital, technology and price-sensitive commodities. Export promotion must not take priority over domestic budget needs, nor be used as an excuse for undermining U.S. anti-trust laws or banking laws. The U.S. should limit the transfer of new technology in order to assure both its national defense and its technological advances.

Foreign grant, insurance and loan programs should be supervised in terms of U.S interests at home as well as abroad. This means that Ex-Im Bank loans, guarantees and insurance activities should be carefully limited both in amount and in the authority to expand the action.

The Overseas Private Investment Corporation (OPIC), a government agency that insures private investment abroad, should be terminated as soon as possible. OPIC has been insuring huge multinational banks and firms abroad and, thus, encouraging the export of American jobs.

Trade with Communist countries should be regulated more effectively through improved administration of Title IV of the Trade Act and by additional legislation that recognizes the economic and political fact of life that private commercial interests cannot negotiate as effectively with closed and managed economies as can governmental negotiators.

Imports should be carefully monitored in all types of industries because of new barter trade arrangements. Emergency action to curb sudden inrushes of imports is necessary.

Fair labor standards criteria must be applied to the acceptance of imports into U.S. markets to assure fair competition. Foreign producers should be required to meet minimum labor standards or face import quotas and other trade restrictions.

To regulate the immense flows of international investment capital, the U.S. Congress should establish a reporting mechanism that would require all potential foreign investors, or those who would take over an American firm or bank to provide the government with at least 60 days advance notice. The government should be authorized to withhold authorization of such investment or take-over in the national interest. Particular scrutiny should be given to take overs or investments in energy sources, minerals, and other natural resources, farm land, and banks.

More attention needs to be focused on the effects of tight monetary policy and high interest rates on trade and investment. The deleterious effects of major short term swings need to be blunted.

Tax loopholes and incentives for multinational companies to move abroad should be ended; the tax deferral halted; the foreign tax credit repealed, and the Domestic International Sales Corporation tax gimmick should be repealed.

The multilateral trade codes adopted in 1979 require constant monitoring and the enforcement of U.S. rights. Only the negotiated provisions should be enforced, particularly in the area of government procurement, where many U.S. agencies, state and local governments were specifically exempted from the requirements of the codes. National security clauses in the code should be used to assure U.S. production and jobs in key industries. No new codes should be completed until current codes are fully monitored and evaluated and no further tariff cuts should be undertaken. The President should report accurately and fully the effects of the code—at home as well as abroad.

New proposals for trade arrangements with America's nearest neighbors, or with any other individual foreign country, should be based on a realistic assessment of the past and future impact of trade and investment not only in the host country but on specific parts of the U.S. economy and on U.S. workers. Differences as well as the similarities of the trade and investment regulations of the respective countries need to be recognized. The United States should continue to try to solve specific bilateral problems, but should not enter into so-called "free trade" areas that could cause massive distortions in import-export balances. We recognize the need to help friends achieve industrial development particularly the poorest of the developing countries. This requires that the emphasis should be on internal development, not on exports to the U.S. market at the expense of U.S. workers. The Caribbean Basin is an excellent example of an area where aid must be realistic to promote living standards and not at the expense of U.S. jobs or living standards.

The U.S. needs a "fair" trade policy that enables this country to have a diversified industrial base with skills and services of an advanced economy, plus a policy that will create full employment and raise the standards of living at home as well as in other countries of the world—all of which will help the U.S. meet the needs of a changing world in the 1980s.

Chairman GIBBONS. Mr. Bailey, would you like to inquire first?

Mr. BAILEY. Thank you, Mr. Chairman. I would like to thank you for the statement that you made. I suppose we may disagree on a few particulars, but you are aware of my position and what I have been trying to say here on the committee. I think you know that we probably do pretty much agree on the problem. You mentioned some of the so-called nontrade barriers such as domestic content laws. Are you aware of the agreement with Canada that Volkswagen recently entered into? Do you have any knowledge? It is all right if you do not. I do not really expect that you——

Ms. JAGER. We are aware of the press reports. We are not aware of the absolute detail. We know that there was an agreement that has been reported that the Canadian Government naturally wanted to have more content in Canada and therefore got Volkswagen to commit itself to making more of the car up there. Since they have the advantage of the Canadian auto agreement, that gives both Volkswagen and Canada an extra advantage. That is not unusual in the world. It is kind of a par for the course.

Mr. BAILEY. It is par for the course, and I will get more details for you. I have been digging into it and have been able to track it down. It serves notice on I think the most important part of the testimony you made today, and that is that this Nation, especially in a day of a deficit trade balance, is going to have to reappraise these words we throw around called fair trade, free trade.

Mr. Chairman, I would like to ask just one thing on the union point of view. What efforts are you making to unionize workers abroad? Are you having any success in penetrating Japan, for example, trying to unionize workers there? I sincerely believe that it is absolutely crucial for the American union movement and union movements around the world to work together in the industrialized free world.

I know that George Meany had that as his ultimate goal. He was very active in organizing the unions in South Vietnam as you may know and was strongly supportive of their efforts there. I cannot envision a free world without them. I wonder where we are going or what kind of growth we are seeing.

Mr. OSWALD. We are very actively engaged. We have just rejoined the International Confederation of Free Trade Unions to try and accomplish that. But what is happening is that more and more countries are preventing workers from exercising the basic rights that we believe in. While very much attention has been given to the Polish suppression of Solidarity, clearly that sort of suppression is taking place in Korea today, South Korea, in Guatemala. It is taking place for black workers in South Africa. It is taking place to a certain extent, not quite as extensively, in Brazil. Today, many places where they are making goods that are being sent into this country, workers are not allowed their freedom. There is not the ability to bargain collectively in these countries or for the workers to have a share in the fruits of that production.

Mr. BAILEY. So you are saying that when the United States of America starts talking about trade barriers and nontariff barriers we ought to begin talking about some kind of reasonable labor standard maybe worldwide. Maybe we should start talking about those kinds of conditions worldwide and looking at those as items of discussion for trade talks? Maybe that is something we should begin to talk about and aim for.

Mr. OSWALD. We believe that is important. Many products are being made in some countries by child labor with children 10, 11, 12—Hong Kong and Singapore. Many of these are violations of standards that have been agreed to worldwide by the International Labor Organization over the last 50 or 60 years. But I think most important is the right of workers to express their own freedom in terms of forming and joining unions and having a voice in determination of their conditions. Otherwise the differentiation between their ability to have an input and the slavery that we all decry becomes a very narrow line.

Mr. BAILEY. Thank you.

Mr. Chairman, could I yield back the time I probably have already used up and perhaps come back with a couple of questions?

Chairman GIBBONS. Sure.

Mr. Frenzel.

Mr. **Frenzel.** I am grateful for the witnesses' testimony and sorry that I did not get here to hear most of it.

As you were concluding, Rudy, were you talking about the extension of 124 authority?

Mr. **Oswald.** Yes, Mr. Frenzel. We believe that that extension is not appropriate at this time. There were such extensive cuts made in the MTN on a multilateral basis that those should be allowed to go into effect. We also believe that individual cuts are also frequently damaging. Recently the United States entered into a bilateral agreement with Japan, for example, to reduce tariffs on some semiconductors. Well, while Japan theoretically is reducing those tariffs, the European Community continues to have a 17-percent tariff on semiconductors, continues to subsidize their production, and in a sense we really have not addressed the problem of semiconductors as an entity that gets adequate access and freedom in the trade relationship with this bilateral tariff reduction with Japan.

Mr. **Frenzel.** Thank you very much. I read in your testimony here that you are opposing the Caribbean Basin Initiative as well.

Mr. **Oswald.** We have worked very strongly on the development of the Caribbean Basin. We have had in existence an affiliated organization to the AFL-CIO, the American Institute for Free Labor Development, to try and help those countries achieve greater development. We have worked for land reform in the Caribbean and the Central American nations, and tried to help them develop cooperatives and other means of internal development, and to develop training programs and other such activities. We believe that is the way to help development in the Caribbean Basin.

We do not believe that a one-way free-trade zone does that. Most of the goods already come in duty free. Those items that do not, do not come in because they do not meet the competitive needs of the GSP, the general system of preferences, either because the imports are so high in dollar volume, or are disruptive to the U.S. market. I see no reason that we should allow those goods to enter now on a disruptive basis.

In terms of providing additional tax benefits for those who invest there, I think that makes a mockery of the very large tax bill that this committee just enacted last year for American businesses to invest in the United States. And this is at a period where we have made those tax benefits in the United States for investment purposes retroactive to January of 1981, and have found no increase in U.S. investment for 1981, and the projections that have been set forth by the Commerce Department for 1982 show no increases in investment in 1982 in this country.

It seems to me very odd that at that particular time period that we have just spent so much of our own tax dollars for investment purposes in the United States, we go ahead and say we are no longer interested in investment in the United States. Even though investment is not going up, we say, we should provide new incentives for the Caribbean for firms in the United States to invest there rather than in the United States. At a time when we have currently nearly 9-percent unemployed, 9½ million people, it seems that there should be much more emphasis on the United States.

Mr. **Frenzel**. Those economies have the capability to produce very few things that our market can use. I suppose textiles and agricultural commodities. If we deny them the sugar and the fruits or the textiles and the booze, then we are not doing anything for them. I guess that I think that we have to find a way to help them if we want them to have reasonably strong economies. Nobody could in their right mind suggest that they are strong now. They are going to have to be able to sell something in our market.

Mr. **Oswald**. And we continue to urge their development. We think that there are other means of trying to encourage that development that are much more effective than the tax incentives that are proposed or the so-called new slogan of a one-way free-trade zone.

Mr. **Frenzel**. Thank you. I yield the balance of my time.

Chairman **Gibbons**. Mr. Oswald, you mentioned that the domestic content requirements of some countries is giving you cause for concern. It gives me cause for concern, too. Has the AFL-CIO brought any action or is it contemplating any action under section 301 about these matters?

Mr. **Oswald**. Mr. Chairman, there have been reviews of questions of 301 on domestic content. We believe on occasion that what may be so frequently used abroad might be an element that we should be looking at doing here in this country, particularly in the automotive industry, where production today is at less than 50 percent of capacity. We emphasize the need for a domestic contents requirement of our own in terms of this basic industry. We believe it would be a terrible situation if the automotive industry went the way of the television industry and that we no longer produced those things that we believe are so essential for this country's basic strength. And one of the ways to assure that the auto industry remains would be to have a domestic contents requirement in the automotive industry.

Chairman **Gibbons**. So you think the solution to the problem is not to get them to drop their domestic content requirement, but for us to adopt a domestic content requirement?

Mr. **Oswald**. In certain industries where that is an essential method for us to maintain our strength, we believe that that is one way that those industries are given a period of adjustment. I think, in some cases, it is an adjustment period that is needed. This is something that could be reviewed periodically by the Congress in terms of whether it is fulfilling the goals and the purpose of providing the assurance of a basic industry in a reasonable manner.

The other problem with the 301 cases and other cases is that so often they are so expensive. The costs are so high, the delays are so long, that the abilities to achieve what is the promise for those who are injured is really denied by the lengthy time period that it takes and the high costs of processing the case. It seems that always the burden of proof is on the injured rather than on those who flaunt our laws. The injured have to prove in great detail all their problems rather than anybody else proving that they abide by our rules and laws.

Chairman **Gibbons**. Do you have any other suggestions as to how we could improve these laws? I am talking about the injury laws, the jumping and subsidy tests, and things of that sort.

Mr. **Oswald**. I would think that we should allow an immediate suspension of restrictions on goods on a faster basis, that we should shift some of the burden of proof so that the presumption is more on behalf of the U.S person injured rather than in behalf of the foreign country which frequently engages in unfair practices. The burden of proof should be shifted and that there should be a quicker, faster way of dealing with the ability to handle the cases.

Chairman **Gibbons**. Ms. Jager, every time I meet with the Canadians they complain about the United States-Canadian Auto Agreement. I would like to have your views of the United States-Canadian Auto Agreement. I ask you that because you seem to be the auto person on this panel.

If you would like to intervene, Mr. Oswald, that is perfectly all right.

Ms. **Jager**. I do not think the AFL-CIO has a policy on the U.S. Auto Agreement. I am a veteran of the agreement which is why I think Dr. Oswald asked me to answer the question. It is a very good example, Mr. Chairman, of what happens when you don't enforce U.S. laws and you work things out with an international agreement. If you will recall, in 1963, the Canadian Government started to subsidize the export of cars to the United States. Instead of enforcing the countervailing duty law, the United States chose to negotiate an agreement, hopefully, to rationalize the industry across the two borders.

There were a lot of things to be said for that at the time. At that time, the industry, the companies already had made agreements with the Canadian Government before the U.S. Government ever signed its agreement. At that point the President of the United States came to the Congress with a bill that promised the workers adjustment assistance. Many of us were led to believe that this would be beneficial to both countries. And in many ways it probably has been. But the agreement demonstrates probably better than anything else the fact that when we talk about trade, we talk about the whole product, and we don't talk about the parts. What happened with the Canadian Auto Agreement was that parts producers, who had very little to do with the major auto companies except to produce for them and sell to them, were pretty much ignored in the agreement. Consequently there has been an enormous amount of unhappiness on both sides of the borders among workers and firms who produce parts for cars.

As you know, the unions are affiliated with U.S.-based unions in many cases. We have very good relations with our brothers and sisters in Canada. As far as I know, there has not been an enormous amount of complaint from the unions on the subject of the Canadian agreement. But it is a good example of the kinds of problems that occur when a solution that ignores the parts that are affected——

Chairman **Gibbons**. The component parts?

Ms. **Jager**. The component parts and all the people who are related to that. As I recall, the first adjustment assistance case was from some people who made some little auto part in Alabama. Yet all the talk about the agreement was about Detroit and Canada.

It should have been an educational experience for the United States. I do not know whether the Canadians are still unhappy with the agreement. I think it has been very beneficial to Canada. In some ways it has been beneficial to the United States.

Mr. OSWALD. I would just add, Mr. Chairman, that so often we talk about these things in a static situation. When the agreement was negotiated, the Canadian and United States dollars were on a par. Today the Canadian dollar is 17 percent depreciated from the American dollar. Obviously that changes conditions, not because of anything that the American workers have done in the industry, but because of the impact of the monetary policy on the exchange rates and the flow of the funds.

Chairman GIBBONS. You mentioned monetary policy, and I know all of us have troubles with the monetary policy from time to time. Do you have any suggestions as to what ought to be done about monetary policy?

Mr. OSWALD. Mr. Chairman, we believe that the Federal Reserve Board should be directed to use the authority that it does have in terms of allocating credit to the particular industries where it would lead to productive uses and to try and assure that we emphasize not only the rates of growth in money supply, but in interest rates as well.

It seems to us that the funds should be restricted for corporate merger purposes, but should be encouraged for corporations to invest in new products. We should try and assure that there are funds for long-term investment both in homes, which are hit disproportionately, in terms of homebuilding, in any overall type monetary policy action.

So we believe that there is need for a more even application of that type of monetary policy to all industries rather than a disproportionate impact on first of all housing; second, autos. Then sometimes State and local governments are hit particularly hard.

Chairman GIBBONS. I do not want to go into too much detail on that, but how would the Fed do that? You say they have the power. I assume that they do.

Mr. OSWALD. Under the Credit Control Act of 1969 they do have that authority. They can exercise that authority in a variety of means, by directing banks in terms of the loans that it makes and a directive letter to the banks and activities. It can direct them in terms of reserve requirements for various actions—for example, for people to buy stock or to speculate on the commodity markets. They can raise the reserve requirements for the amount of down payment that somebody has to make on what I would call more speculative investments.

They can require that a certain amount of money be put into housing, for example. There are other ways that the Federal Reserve Board can influence both interest rates and reserve requirements than just trying to use the discount rate or the overnight Federal fund rates.

Chairman GIBBONS. You mentioned the dollar having appreciated 25 percent on a trade-related basis against various countries. What do you think the Fed should do to influence that?

Mr. OSWALD. I think that a domestic policy that emphasized lower interest rates would also have the impact on the international relationship and the flow of dollars. It may even be that at some stage one should limit the free flow of funds if that becomes the only way in which one temporarily can make adjustments in the valuation of the dollar.

It seems to me that there needs to be some mechanism of assuring that the full brunt of those actions not fall disproportionately on the homebuilding industry, those that are engaged in trade actions or others, and that the Federal Reserve actions should try and get at those sectors where there is really an inflationary push. The Fed should deal with those much more directly.

Chairman GIBBONS. You mentioned trade adjustment assistance and I have got to say I feel a little sensitive on that matter because in this very room I have fought the battle for trade adjustment assistance because I thought it was the just thing to do. But every time I did some of your predecessors would corner me and say, "Hey, we don't want that burial insurance, Sam, we want something else." And perhaps for that reason I cooperated with the administration in the dismantling of the trade adjustment assistance program that we have now.

I was not too happy about the way the almost expired program worked. I do not think anybody who looked at it very closely was. People were getting benefits after they had already gotten back to work and the benefits seemed concentrated in just one or two industries.

So, I want you to know I am willing and anxious to work with you, but we are going to have to sit down and have a better understanding of each of our motives on that before we can get much accomplished. I do not know whether in the current political environment we could get a lot accomplished, but it is something that I worry about. I think when a person gives up their job because of a change in national policy or an implication of that policy that they should be protected while they make the readjustment. I am concerned about that.

Mr. OSWALD. We thought that was the promise that was given to workers in the 1979, multilateral changes, and of course in 1974 as we went into the multilateral trade negotiations. We always believed that just because there is poor administration of an act, one doesn't improve the administration by repealing the act. One does it by directing those who administer the act to handle it in the way it was intended to be handled and that is to provide, where it can, effective support for those who are thus injured.

Chairman GIBBONS. I want to tell you, maybe my experience—my recollection of my experience—is jaded, but every time I tried to talk about adjustment assistance in the past, I have always kind of gotten rebuffed by your predecessors with the exception of when they thought it was about to be repealed as it was last year, I never saw them ever really talk about wanting it.

Mr. OSWALD. Well, I think, Mr. Chairman, when you talk about it as burial insurance, I think you describe the way that many union members and workers have felt about it. But they have always tried to negotiate burial insurance. It is better than being left out in the potter's field and not buried decently. It is not the solution to certain problems, but one wishes to be buried with dignity if one is going to be buried.

Chairman GIBBONS. Well, I understand that. You complain about the slowness of the process of enforcing the countervailing duty and antidumping laws. Does the AFL-CIO have any cases now before the International Trade Commission?

Mr. OSWALD. There are a number of cases in which our affiliated unions are deeply concerned. They range from the steel cases to some of ceramic tile.

Chairman GIBBONS. Are you all a party to the steel cases?

Mr. OSWALD. No; but clearly they have substantial impact on our members.

Chairman GIBBONS. Yes. Mr. Bailey?

Mr. BAILEY. Thank you, Mr. Chairman. Incidentially, in most of those dumping and countervailing duty cases you would have a second class standing or whatever. You really would not have the resources—not that you couldn't join. In most cases the companies would be best situated to bring those kinds of cases?

Mr. OSWALD. Not only are the companies better situated, they have better access to the information that you have to supply.

Third, as indicated, this problem of burden of proof is so difficult to establish. The petitioner has to prove what the people in foreign countries are doing. Frequently we get very little help from the administration. We have asked repeatedly that it should be part and parcel of the job our foreign economic counselors to be reporting on unfair trade practices, on dumping practices, on subsidy practices. They should be agents to help enforce U.S. trade laws, to assure that they do what they are supposed to do, and that is take care of information on these issues.

But, instead of finding the economic counselors engaged therein, we are given the impression that their primary goal today is only to achieve greater export penetration. While we are interested in greater export penetration, unless they do the other side of it and say that when foreign countries engage in unfair practices then our economic conselors will become important links in providing that information, you never can put together the cases. And nobody has the money, sometimes. Some of those cases can run $400,000, $500,000 for presenting a case.

Mr. BAILEY. The point is those trade laws look so good on paper but as a practical matter have been ineffective. They have not worked very well. The very important strong right arm of the Government or administration that is needed to try to enforce them or try to help with them has never really adequately been there as a matter of policy. I think because there is an obvious fear that people don't want to get into some type of back and forth kind of trade war. It is a domino kind of thing. Sort of let the thing develop in some kind of a gray, murky, jawbone area because if we start establishing law or we start laying down precedents here, we are going to lose some international flexibility or cause some kind of problem.

In that connection, I would like to comment on what Mr. Frenzel said earlier. I really believe that for many of the developing nations we have to develop trade laws and practices that help those people in the best way possible. I really believe, and I think you probably agree with me—most people would, I assume—that means some type of preferential treatment for those developing economies at certain times to make sure they do attract some investment and they grow. That is good for world stability and it is good for us. I do not know why we are so naive to carry these kinds of perceptions and thoughts on to the developed countries. I mean, do we need, in your opinion—or should we tolerate for that matter—trade practices with a country like Japan for example to get that country on their feet. Do we still need to help Japan get on her feet?

Mr. Oswald. Clearly not. If anything, we keep on talking as you say with Japan for 10 years and frankly, no change.

Mr. Bailey. Incidentally, that was not what Mr. Frenzel said. I went from his earlier subject.

Mr. Oswald. We still have $20 billion of trade deficits with Japan. For 10 years or longer we have been asking them to bear a fair share of our defense costs. They are still talking.

Mr. Bailey. Do we need to help get Europe on her feet? Did the Marshall plan help somewhat? Do we still need——

Mr. Oswald. That seems to be the approach when we are fearful of taking antidumping cases against the Europeans in the steel industry. Clearly there have been major subsidies, where there has been dumping.

Mr. Bailey. There have been major subsidies?

Mr. Oswald. The Commerce Department recognizes that there have been.

Mr. Bailey. Ambassador Brock does, I can tell you that.

Mr. Oswald. But they are fearful about our taking the antidumping and countervailing duty route as if that is somehow going to disrupt the elements, and yet the law is there, we are supposed to be doing it.

Mr. Bailey. Can I end with this? I have a minor criticism of you folks and then you criticize me for saying this if you will.

I will tell you one of the problems I have seen. I see in the face of some of our international difficulties, finally our American unions and American capital are beginning to talk about trade issues. In conjunction with that it just seems to me that is very, very important to talk about for example American tax and domestic law as an overlay, something that is very much connected with and integrated with trade policy. I, for example, was the author of an infamous amendment because I accepted the name, it was the only way I could get the attention that we needed for it called the Bailey bailout. To be honest, I didn't get the wisdom of my colleagues and their help. I really didn't get that much help from either side even though what I was saying was very consistent with the AFL-CIO policy, in fact you had something like it in your tax program. I also found that much of American capital, at least the capital intensive industries, did not identify with it. Ford didn't do that much either because it wasn't fine-tuned enough for either side. I just hope that we start working together as union and capital to understand what some of these problems are a little better. Otherwise we are going to go down the chute.

You need to help us develop a concept for free enterprise in a mixed economy. I do not believe in a socialist economy. I do not like those creaky economic systems that the totalitarian systems have built up. There are not enough people out there that know what the AFL-CIO stands for. I mean that sincerely. I think the unions and capital in this country—it is vital that you develop some sense of world definition for what free enterprise means so we can do something about subsidy that doesn't mean the same here as Europe and Japan. Then we can talk about market conditions that have different definitions in those countries or we are not going to have a free, independent economy. It is not all Government's fault. You folks are part of the problem. That is my opinion.

Chairman GIBBONS. I think you make a good suggestion when you suggest that the Government representative abroad should be doing more to try to ferret out the unfair practices that competitors are engaging in. I will be sure to talk to Commerce about that and take a closer look at that and see if we can't improve our performance.

Second, let me make it clear, I am happy that the steel industry has finally thrown down the gauntlet on the matter of subsidies and dumping and I hope that they will vigorously pursue the cases and not just sit down and negotiate out some settlement that they will continue to complain about. I think we need to rid ourselves of that problem, and while I know it is going to be painful, I am glad they are doing it. And I appreciate your taking time to come back here this morning and talk with us again about this problem. We always welcome you and we are glad to see you.

Our next witness is Leo Johnstone, the vice chairman of the board, Phillips Petroleum. He is accompanied by F. M. Hunt, chairman of the International Trade Committee, Chemical Manufacturers Association, and Myron T. Foveaux, a legislative representative of the Chemical Manufacturers Association.

STATEMENT OF LEO JOHNSTONE, VICE CHAIRMAN OF THE BOARD, PHILLIPS PETROLEUM CO. ON BEHALF OF THE CHEMICAL MANUFACTURERS ASSOCIATION, ACCOMPANIED BY MYRON T. FOVEAUX, LEGISLATIVE REPRESENTATIVE

Mr. JOHNSTONE. Good morning. As I said, my name is Leo Johnstone, Mr. Chairman. Thank you for the opportunity to be here. I speak here today on behalf of the Chemical Manufacturers Association, whose 184 U.S. members provide more than 90 percent of the capacity to produce chemicals in the United States.

The chemical industry is vitally interested in and affected by trade policy. In 1981, exports of chemicals totaled $21.3 billion, which was 9.1 percent of all U.S. merchandise exported. Exports accounted for 11.6 percent of total U.S. chemical sales. Allowing for imports of $10 billion, the chemical trade surplus was $11.3 billion. We think you will agree that the chemical industry has been making a positive contribution to the U.S. economy, to our international trade balance and to the strength of the dollar.

I am here today to outline the status of our chemical industry, to describe our ability to compete in an open market, and to discuss the problems confronting us in the short run as well as over the next decade or so.

If we are to continue to make our current economic contribution, both industry and government need to understand the international environment in which we compete. Let me first briefly review the conditions which enabled our industry to attain its current competitive position.

Our base in the U.S. market has been the major factor of our industry's global strength since World War II. We have benefited from our large homogeneous market, which remains the envy of our foreign competitors. Having invested our own risk capital in developing new products for our own market, we have been in excellent position to expand our production base. For more than a decade after World War II our output expanded rapidly, reaching annual growth rates of between 20 and 30 percent. During the 1960's and 1970's our technological know-how and our economies of scale were the bulwarks of our competitive effectiveness.

We frankly acknowledge that we have benefited from our feedstock situation. The United States is well-endowed in natural gas and natural gas liquids. Most of our foreign competitors are not—or at least they have not been until recently, as a result of new discoveries.

Price controls on oil administered by the U.S. Government after the Arab Oil Embargo of 1973 also gave us a competitive kick. However, our foreign competitors have made more of this than the facts warrant.

We firmly believe that the quadrupling of our chemical exports between 1973 and 1980 was based less on our favorable raw materials costs than on factors of superior technology, expanding domestic market, favorable exchange rates, and integrated refining configuration.

Our booming domestic market gave us the base we needed to promote our exports. We had favorable circumstances at home and we took advantage of them.

As we review the status of our industry in the current economic environment, it is clear that the chemicals industry is economically sound, but only as compared with, for example, the severely depressed chemical industries in Europe.

The lack of real economic growth in the United States and abroad has led to an overcapacity situation. We must recognize that until economic recovery is achieved, serious dangers of protectionism will loom on the horizon of our industry, and of others as well.

Given the generally depressed world economy and the outlook for continued overcapacity in much of the world's chemical industry, there will be a fierce battle for chemical markets around the world, including those in the United States. Competition, of course, is healthy, but only when all competitors play by the same rules.

The most serious short-term threat to the U.S. chemical industry is the temptation by foreign governments to manipulate rules of trade and investment in order to subsidize national production and sales or to restrict imports.

Moreover, with trade barriers now substantially reduced, we must now be alert to foreign governments imposing new tariff and nontariff barriers to boost employment and reduce competition in their own markets.

New barriers erected for short-term, antirecessionary purposes could create a protectionist spiral which would be extremely difficult to unravel once our economies have recovered.

Trade barriers, especially tariffs, are now well below those of the last 50 years. New codes of international trade behavior negotiated in the Tokyo round are essential additional steps toward a rational trade policy for the world's markets.

Their existence by no means guarantees compliance, however, and we believe that the United States must insist strongly that its trading partners behave responsibly in applying these codes.

There are also longer term problems in the trade area. The involvement of governments in the petrochemical industry is increasing worldwide, even in countries, including some in the European Economic Community, which have historically had free-market economies.

As a consequence, political and social pressures begin to undermine the competitive marketplace. We believe the trend among governments to manipulate rules of investment and trade, and to subsidize production and sales as instruments of national policy is a serious problem for U.S. industry.

Foreign governments, including Mexico, Canada, and some OPEC countries price their domestically supplied petrochemical feedstock well below prevailing market rates.

Some governments, including France and Brazil, have nationalized all or significant parts of the industry or have forbidden or severely restricted foreign investment. Yet, their industries compete with ours—both in our home market and in Third World countries—with their subsidized end products.

Elsewhere, especially in Eastern Europe, governments are increasing their position in world chemical trade, often via barter or compensation agreements and without regard for real costs. Not all governments in energy-rich areas are adopting policies to enhance unfairly their competitive position, but trends in that direction are evident and must be carefully monitored. Ways must be found to deal with these enhancements.

The implementation of the generalized system of preferences, instituted in January 1976, is also becoming a serious problem to members of the chemical industry. We support GSP as a policy to help developing countries achieve export-led growth as part of the Government's development strategy for the Third World.

However, GSP can lead to problems that should be minimized or avoided.

GSP's purpose of assisting developing countries has also been undermined by the way it has been administered. The graduation procedure adopted in 1981 appears to us to deserve added emphasis. Under this procedure, the temporary loss of GSP status, due to the competitive need limitation, would ultimately lead to a permanent exclusion from GSP eligibility.

Petitions for inclusion of new products also require appropriate review procedures by the respective agencies and stricter limitation to specific products for which benefits are sought.

It should be impossible to open up large so-called basket categories for GSP benefits without adequate scrutiny, justification, and careful study of the harm that could be inflicted on the American producers of all products falling into those basket categories.

Finally, with respect to GSP, the United States should aggressively seek balance in trade policy actions in the future. Mexico, for example, has requested that a very extensive list of chemicals be made eligible, many of which are not now produced or are still in short supply and being imported by it.

At almost the same time, Mexico placed a requirement for import licensing on a very large number of products, including chemicals, which will inhibit imports to that country.

Advantages to our exports must be obtained to counterbalance export concessions afforded other countries. The time has passed for opening up the U.S. market to this type of entry without offsetting gains.

The Domestic International Sales Corporation [DISC] is another essential element of U.S. trade policy. The incentives offered by other governments make it so. The success of the industry's export effort depends to a significant degree on DISC. As long as our major trading partners provide tax incentives and credits which benefit their exports to a similar or even larger degree, pressures in this field should be strongly resisted.

I might say parenthetically that we support the Frenzel bill, we agree that this is an excellent vehicle. We would like to have an input at the proper time with respect to the Frenzel bill, because there may be some fine tuning that we could suggest.

The chemical industry has high praise for the trade advisory system. The Trade Representative's Office and the Commerce Department made the Industry Sector Advisory System work effectively during the Tokyo round.

The new Industry Sector Advisory Committee arrangement, as well as the Industry Policy Advisory Committee, is necessary to maintain surveillance and to assure that the MTN agreements are implemented by other countries.

It is especially pleasing to report from my personal experience how well government-industry liaison can work. The Trade Representative's use of chemical industry representatives in the recent consultations with the Common Market was most effective.

We are encouraged by what seems to be a better understanding in the Congress and the administration of the need for coordinated action in trade policy matters.

In short, we believe there has been remarkable progress in liberalizing world trade during the past 36 years. The chemical industry has prospered by this process. We know that the emerging international environment will be much more competitive. We do not shy away from this competition.

On the contrary, we feel confident that we can meet it. But we can do so only to the degree that the international marketplace is as free and open as the U.S. market has been. We are, unfortunately, not fully confident that all trends point in that direction.

Finally, let me turn to investment issues, which are now competing for attention with trade matters. There are many purely economic reasons for this, including the gains associated with proximity to marketplace.

In recognition of this economic opportunity, the U.S. chemical industry has invested about $19.5 billion abroad in dozens of countries. We now find, however, that these opportunities for investment are shrinking, not because of economic factors, but because of political obstacles imposed by foreign governments.

There are serious limitations to investing in Mexico, Canada, France, and the OPEC countries, and the list is growing longer. Governments, eager to spur on domestic industry, limit the opportunities for foreign firms to invest. Moreover, local markets are often too small to justify the scale of investments being made. In such instances, the obvious target is penetration of the U.S. marketplace.

Also, the existence of an effective ex-U.S. patent system has become increasingly more important as the U.S. chemical industry moves aggressively into life science and invests heavily in the development and commercialization of high-technology products serving basic human needs.

Even though the U.S. chemical industry has literally thousands of patents in over 100 countries, most developing nations and nonmarket economies provide inadequate or unsatisfactory patent protection.

Some countries, for example, People's Republic of China or Indonesia, do not have any patent laws. In other countries, materials with biological activity are either not protected at all or are given less protection than other types of inventions.

Unfortunately, without strong patent protection to provide adequate return on research and development and subsequent commercial investment, there is less incentive for private business to adapt technologies or products to local needs—thus hampering the development of those LDC's.

In addition, in some cases, countries have granted licenses for U.S.-developed patents to a non-U.S. firm which has undermined the basic foundation of international trade and law.

To improve trade relations between the United States and developing countries, our Government must continue to seek an effective method to protect and to insure U.S. international industrial property rights.

We not only have in the United States the largest homogeneous market in the world, but we also have the most open investment environment of any country.

This is a market for chemicals that was developed by the innovative entrepreneurship of U.S. industry. We want to preserve an open market for products and for investment by others. But pressures to restrict this market will grow unless the international investment trend is reversed.

We are hopeful that this Congress and administration will be sensitive to adverse trends in investment and will deal with them with the same spirit in which adverse trade policy trends were reversed in the past.

It is important that in handling investment disincentive abroad, the U.S. Government tries to assure that the international investment climate is equitable.

In conclusion, the world in which our industry is competing is rapidly changing. We urge the U.S. Government to adopt policies appropriate to these changes and to maintaining the ability of the U.S. petrochemical industry to compete on a world basis. We in the industry stand ready to work with you in achieving this end.

That concludes my testimony, Mr. Chairman. Your questions or comments would be most welcome.

Chairman GIBBONS. Thank you, Mr. Johnstone. I noticed in your list of countries, you did not ever mention Japan, I believe, or maybe I am mistaken.

What is our relationship with Japan as far as the chemical industry is concerned?

You mentioned Mexico, Canada, France, and Brazil.

Mr. JOHNSTONE. I was referring specifically there to investments.

Chairman GIBBONS. Yes, sir.

Mr. JOHNSTONE. Investments can be made in Japan, although I think you will find that most of the investments made in Japan have been joint ventures with Japanese companies for the sake of ease into the Japanese marketplace.

Chairman GIBBONS. I assume Mexico is expanding its chemical industry because of its discovery of so much oil and natural gas.

Mr. JOHNSTONE. Yes, sir. The history there is—it was in connection with the oil production—they have a great deal of natural gas production. And they are seeking to expand their petrochemical industry, primarily based on the large amount of natural gas for which there is a limited market.

I think you will find in Mexico they are also promoting the internal use of natural gas for heating as opposed to using fuel oil, in that oil is more readily exportable than natural gas, more options with regard to the market.

Chairman GIBBONS. Specifically, what are the Mexicans doing that you object to?

Mr. JOHNSTONE. By law, in Mexico the petrochemical industry, that is what they call the primary petrochemical industry, is limited to ownership by PEMEX, the Mexican National Oil Co.

There is no opportunity for a U.S. company to go to Mexico, invest in a manufacturing, marketing venture in Mexico—because by law, it is limited to PEMEX—through a certain generation of chemicals.

Such things as the commonly known polyethylene is one example. That is limited to PEMEX.

Other ventures downstream are U.S. companies are limited to 40 percent ownership. So what we were talking primarily about there was the limitations placed on U.S. companies in Mexico without limitations on Mexican companies in the United States.

Chairman GIBBONS. Do you have any problems getting your chemical products into Japan?

Mr. JOHNSTONE. Yes. It is difficult for me to be all that specific about it—although here recently chemical products going into Japan have been on the increase.

As a matter of fact, there is a complaint that is being handled through the Trade Representative's Office with regard to the increase of chemical imports into Japan.

Now, there are difficulties in doing business importing into Japan. But I would have to say in view of the track record that it can be done.

Chairman GIBBONS. Mr. Bailey.

Mr. BAILEY. Thank you, Mr. Chairman.

Importing into Japan. What is Japan importing, can you tell me—some feedstock-type materials or what? What kind of chemical materials?

Mr. JOHNSTONE. I think one of the major imports of chemicals into Japan, as I recall, is ethylene glycol.

Mr. BAILEY. Used in antifreeze?

Mr. JOHNSTONE. The ethylene glycol I am referring to is primarily used in the fiber industry, to produce polyester fiber.

Mr. BAILEY. Can Japan import—naturally it is a hydrocarbon—can they import the petroleum or the gas or whatever you use to make it?

Mr. JOHNSTONE. The Japanese chemical industry is based on liquid petroleums. The production in the United States is based on natural gas liquids, which have been under price controls.

And so there has been some advantage in feedstock prices in the United States. And this is really the basis of their complaint.

Mr. BAILEY. If I might interrupt you. Those regulated prices, of course, have not affected imported hydrocarbons. They basically have been, as I understand it—maybe I missed something—but on the natural gas we have produced here at home and the oil here at home, is that right?

Mr. JOHNSTONE. Yes.

Mr. BAILEY. What are the Japanese importing that for? Do you know why they are importing? Why has there been an increase in imports?

Mr. JOHNSTONE. They claim it has been a matter of price, that there has been an advantage to operating costs, the U.S. producer of certain chemicals who have been able to move those chemicals to Japan at a lower cost than they can produce them internally.

Mr. BAILEY. OK. The second half of my question. You apparently have some experience with this. You mentioned the difficulty of market entry in Japan or marketing products in Japan. At least you commented in a way you have such experience.

Let's take a product now that the Japanese have—can produce efficiently or cost-effectively, or competitively.

Mr. JOHNSTONE. What was that question?

Mr. BAILEY. Let's take a product the Japanese can import the feedstock materials for and produce competitively.

How does your competition go then? Obviously they need the ethylene glycol. But what happens when it is not something for which you have a fair chance to compete in that market, in your experience?

Mr. JOHNSTONE. Well, the products that we are talking about primarily are more or less the commodity-type chemicals. Now, certainly in the specialties, or the high-technology chemicals, there is also movement of those products to Japan.

Now, one thing—I have talked about feedstock costs here in the United States. And, of course, with the phase-out of natural gas controls or whatever happens, that particular relationship—that is going to change.

Mr. BAILEY. Right. That is going to go up.

Mr. JOHNSTONE. But we here in the United States have an extremely large chemical industry. We have large plants which have the economy of scale. And in many respects, they are more economical, because of that economy of scale, and because of technology, than plants in Japan, or plants in Europe.

Of course, this is the point that we tried to get across in our discussions with the Common Market people, because of their complaints about increasing imports from the United States into Europe. We have a very strong industry here.

Mr. **Bailey**. Then what protectionism have you seen in Japan? Have you seen any? Does that apply to your industry? I don't know. I just don't know anything about your industry.

Mr. **Foveaux**. Mr. Bailey, our best competitive strength does lie in the specialty products which any country, whether it be Europe or Africa or South America, needs, and Japan needs some of these, because they do not have the complete chemical industry we have.

We have been competitive in the petrochemicals because they have had to buy high-priced naphtha at the same time we have indigenous gas.

Now the protectionism you speak of lies largely in the selling and distribution system. Most American firms who market in Japan do not have the usual kind of marketing operations that they have, for example, in Europe and other places.

Mr. **Bailey**. So you cannot really go in and sell—forgive me if I don't describe this right—you cannot really go in and sell the end of your product line so much.

What you have to do is go in and sell the components or the chemicals that they then use to fabricate the different molecular formulas that they want to turn into chemicals.

Mr. **Johnstone**. That's right. And usually the sales by U.S. companies—I state this as a generality, although I don't have the data on it—but I would say they are usually—the sales in Japan are through Japanese trading companies as opposed to——

Mr. **Bailey**. They have to do that when they sell over here?

Mr. **Johnstone**. No. No way.

Mr. **Bailey**. It might be real interesting if some of your ethylene glycol ends up in a finished product back here competing with something that is a finished product of yours.

Have you ever bumped into that?

Mr. **Foveaux**. Mr. Bailey, may I interrupt to answer——

Mr. **Bailey**. Please.

Mr. **Foveaux**. On an earlier question—we have been the recipients of a tremendous competitive advantage with regard to the currency values already referred to here this morning. During the course of the 1970's, we saw a decline in the value of the dollar by roughly one-half against the major currencies.

During all that time, we received a tremendous benefit of greater exports and competitive strength in foreign markets. So these other countries have experienced our exports, their imports, as a result.

That situation turned around, as you probably know, in the appreciation of the value of the dollar last year. Our exports fell off noticeably.

There is a time lag usually of 4 to 6 months in the effect on exports because of contracts. But we suffered a pretty serious falloff of exports, even to Japan, just as a result of the change in the value of the dollar.

It turns out these changes, with the float of the dollar against the other currencies, especially in these last 4 or 5 years, have been of greater influence than tariff rates. This is a very important point to our industry.

And, of course, the value of the currencies is literally out of control.

Mr. **Bailey**. I am just looking down the road 15, 20, 30, 40, 50 years. I am just looking at America's industrial base, and I am getting frightened.

Investment patterns, you alluded to them. I just don't know what is going to happen. Currency fluctuations, I suppose we can address in other forums.

Thank you. Thank you, Mr. Chairman.

Chairman **Gibbons**. Mr. Frenzel.

Mr. **Frenzel**. Thank you, Mr. Chairman.

Mr. Johnstone, thank you for your testimony. I am particularly grateful that you mentioned the bill that I have introduced, along with the chairman, to begin the dialogue on improving our export incentives.

You indicated you had some changes in mind. I hope you do, and I hope you communicate them. We introduced that bill very quickly for the reason that we wanted to be sure some of our European friends noticed it.

It does need a lot of work—particularly with respect to purchases from and sales to related parties. I am sure that is one of the problems that you are concerned about.

I did want to ask, however, in your sales of petrochemical-based products to Europe, have you been subject to dumping or countervailing charges?

Mr. **Johnstone**. Yes, on a few products.

Mr. **Frenzel**. Are those the ones that have a natural gas base, and they object, of course, to our controlled price system here?

Mr. **Johnstone**. Not entirely. Some of those started back when we had oil price controls.

So some of the dumping charges were against chemicals that were derived from oil. Now, that has been pretty well taken care of, of course, with the ending of price controls early last year on oil.

Now, we still have a few dumping charges pending. But the big rush of dumping charges seems to have died down, although it is still being pursued to some degree.

The chemical industry in Europe has been very vocal, and very aggressive about pursuing dumping charges.

There has been a good deal of pressure on the Common Market to push through those dumping charges. I would say, however, I believe that they have done their best to handle this in a very statesmanlike manner.

Certainly charges back and forth don't necessarily lead to solutions to problems. And so there has been serious discussion about possible solutions.

Mr. **Frenzel**. Well, is that your biggest problem in Europe, or is the investment problem your No. 1 priority there?

Mr. **Johnstone**. I would say that dealing with investment—investment is probably a larger problem. I think some of the other—the dumping thing, in my own view, I think it is a passing phase. It is related to the state of the economy at the present time, the differentials in price controls that exist at a point in time.

I don't view that as the long-term problem. I do view, however, the differences in the ability to invest as a more serious and more fundamental problem.

Investment and trade just go hand-in-hand.

Mr. **Frenzel.** I agree with you. We have so many problems that are outside of the GATT—interest subsidies on credit sales, many tax systems, investing, currency floats or nonfloat systems, all of those things are outside the GATT.

We have limited ability to deal with them on an integrated basis. So we are going to have to begin to pull these things together in a more effective manner.

I thank you, also, for your estimates on GSP's. This committee, I think, has taken the same kind of attitude that you have, that GSP is a nice feature, but there comes a time when graduation is necessary and when you get into the kind of industries that you are talking about, you are a little more than an LDC.

Thank you very much for your testimony.

Mr. **Johnstone.** Thank you.

Chairman **Gibbons.** Mr. Pease?

Mr. **Pease.** I have no questions, Mr. Chairman.

Chairman **Gibbons.** Mr. Schulze?

Mr. **Schulze.** Thank you, Mr. Chairman.

Mr. Johnstone, I appreciate very much your testimony. You referred to Mexico and problems with Mexico. Mexico is our third largest trading partner, with us buying about 60 to 70 percent of their exports. Yet they have taken some relatively blatant, in my opinion, protectionist moves and measures.

Quite frankly, I think it is about time we had a system of reciprocity, where, when another country takes those types of protectionist actions, we reciprocate, either in that field or a related field, or even an unrelated field if we cannot find something else that is appropriate.

I would like very much to have your thoughts on that, and see if you have any suggestions.

Mr. **Johnstone.** I quite agree with you in principle.

Some of the actions in Mexico have certainly been protectionist—requiring investment when the market may not really justify that investment at this time. And it is a strange dichotomy—because in some cases they are requiring investment, and in other cases they will not permit us to invest.

I think we in the chemical industry feel somewhat frustrated with regard to Mexico.

Now, with regard to reciprocity, I think that, as I say, in principle we would agree with that. It is a very difficult subject, however—very complex, as you well know. Because, what does represent reciprocity?

You can have a case of one country—if we say just in principle that we would like for the U.S. chemical industry to be able to play on a level playing field with companies or products manufactured in other countries—how do you achieve that? There may be differences in raw material costs—witness Mexico-Canada. There may be differences in investment cost. The Canadians say it costs maybe 30 percent more to build a plant in Alberta. There may be differences in labor costs. There may be differences in financing costs.

So, reciprocity, while I think we can subscribe to it in principle, achieving it may be quite different, and, in the second place, it is going to be a moving target, because conditions change.

So, if there is a reciprocity approach, I certainly think it would have to be flexible enough so it can be updated as conditions do change. Oftentimes, the trap we fall in is that we get something set in concrete, and when conditions change, we do not have the ability to change with them.

Mr. SCHULZE. It seems to me, Mr. Johnstone, if we had such a policy and used it once or twice, we would not have to use it again.

Mr. JOHNSTONE. That could very well be.

Mr. SCHULZE. If they knew we were not going to play the game any more of having the widest, most open markets in the world that everybody is after, and will let anything in at any price, anywhere, anytime; that when they play these games, we are going to reciprocate in spades. I don't think we just ought to do it on an even playing field.

If they are going to play this game, we ought to jump in with both feet. I am tired of being jumped all over and doing nothing in return. I am also tired of nontariff barriers and tariff barriers and subtle trade barriers all over the world, and with our markets being penetrated day after day. I think it is about time we do something, and stood up for our own rights. And I think if we did that, just a couple of times, the word would go out, and this game would stop.

I just think it is time. With our own economic problems, we no longer should be the dumping ground for unemployment around the world. I think the time has long passed when we should do something.

Thank you, Mr. Chairman.

Mr. BAILEY. Mr. Chairman, may I ask one more question?

I believe Mr. Foveaux—I am not very knowledgeable about such things—you made some comments at the end of my questioning period about currency problems.

Could you put a little more substance to that comment? You were talking about currency difficulties and the impact they have had on—at least in your situation exceeding that of tariff or trade problems. And the thing that caught my mind is you finished up saying these problems are out of control.

Would you elucidate?

Mr. FOVEAUX. Well, the value of the U.S. dollar varies with many, many things, as you know. It varies with the interest rates, in the United States, which Europeans and others are complaining about. It involves a lot of things.

A German or French or British customer for our exports have their currency in hand, and all of a sudden over a period of 3 or 4 months, let's say in this past year, our dollar went up, and the currency they hold in their hand buys fewer of our dollars. But our price on a given product remained the same in U.S. cents per pound. And all of a sudden, as a result of that, the competitor of this export product of ours in any one of those countries, is suddenly in an advantageous position overnight by say, a 15- to 20-percent margin.

So, then, getting to the question of what does the future hold—will the dollar go up or down? Of course, we don't know that. Apparently no one does. But we have learned that over the 1970's, as I said before, that the constantly dropping value of the dollar made our goods a bargain abroad. The strong currencies were increasingly worth more in U.S. cents.

Mr. **Bailey**. OK. I understand that. But I misunderstood you. I thought in terms of the question that I was asking about Japanese practices, there was a connection I did not see.

Mr. **Foveaux**. I am sorry.

Mr. **Bailey**. No. I thank you very much for clearing that up for me.

Thank you, Mr. Chairman.

Chairman **Gibbons**. Thank you very much, gentlemen.

Our next witness is Dr. Karl G. Harr, Jr., president of the Aerospace Industries Association of America.

STATEMENT OF KARL G. HARR, JR., PRESIDENT, AEROSPACE INDUSTRIES ASSOCIATION OF AMERICA, INC., ACCOMPANIED BY ALLEN H. SKAGGS, VICE PRESIDENT, CIVIL AVIATION

Mr. **Harr**. Thank you very much, Mr. Chairman, members of the committee.

I have with me Mr. Allen Skaggs, vice president, civil action, of the Aerospace Industries Association, to help me answer any questions you may have.

Mr. Chairman and members of the committee, I am Karl G. Harr, Jr., president of the Aerospace Industries Association of America, Inc., representing the Nation's major manufacturers of commercial and business aircraft, aircraft engines, helicopters, and related components and equipment. It is a pleasure to appear here today to discuss some of the trade concerns of pressing interest to American aircraft manufacturers.

As you know, we are a strong, innovative industry, but we are also fragile. We are living in a different world today than we were even 10 years ago—different economically, socially, and politically. Variables have entered the picture which seriously threaten U.S. supremacy in aeronautics and aerospace.

Someone said to me yesterday the future is not what it used to be.

I will get to some of those variables in a moment, but first I would like to put our industry in perspective. As I have said, we are strong—at least at the moment; 87 percent of all turbojet transport aircraft flying in the free world today are American made. Registering an estimated $18.1 billion in exports, as contrasted with $4.3 billion in imports, the aerospace industry continues to be a major positive contributor to the U.S. balance of trade.

Of course, the benefits of such strength go well beyond the stated numbers. For each $1 billion in sales, aerospace exports create several times that in total economic benefits—consumer goods, food, housing, business equipment, government purchases, and jobs.

Nearly every State in the Nation receives direct or indirect benefits from export sales of aircraft.

The other side of the coin, however, is that every State has the potential of being hurt should aircraft exports slip. However, several disquieting elements have entered the competitive picture. Although I will cover two of these, I will dwell on only one as the basis of my presentation here today.

Keep in mind that our industry is seeking to adjust to a number of significant forces. First, fuel costs have risen drastically, which, combined with the soft economy, has resulted in decreased traffic and airline profits, which directly affects airline ability to purchase new equipment. To break this circle, we need to build the optimal fuel-efficient aircraft, a task requiring many billions of research dollars.

Unfortunately, despite a continuing industry commitment to aeronautical research, Government-sponsored R. & D. has been targeted for huge cuts or possible extinction by the administration, jeopardizing the future competitiveness of American-built aircraft. In the future, the world's airlines will simply have to buy the most fuel-efficient aircraft available, regardless of country of manufacture. If it is an American design, fine. If not, too bad.

Second, and to us most crucial as a factor in the competitive equation of the future, is the sheer growth in manufacturing and marketing muscle of our European competitors, and now other national competitors outside of Europe as well.

The U.S. aerospace industry—and the country as a whole—has always taken its lion's share of the world market for granted. But now, as we are entering 1982, continuation of that state of affairs is no longer certain.

Our competition is strong, competent and, most importantly, well-financed—and most of it is Government controlled.

The strength of the foreign competition we face is evidenced in the trend in Airbus sales. Airbus now claims 43 airline customers, with more than 150 A-300's already in service. As of September 30, 1981, firm unfilled orders for the A-300 and A-310 numbered 179, compared with 236 unfilled orders for widebodied aircraft among U.S. manufacturers.

Counting deliveries, firm backlog and options, Airbus is claiming to have sold 600 aircraft—an extraordinary number. Moreover, the fact that airlines tend to stick with their choice of aircraft through at least one generation means that orders lost now are likely to stay lost for 20 years or more.

The anticipated demand for new jetliners over the next decade will be between 4,000 and 5,000 airplanes—or approximately $120 to $130 billion in 1982 prices—with more than 6,000 aircraft—up to $150 billion—needed by 1995. At least 60 percent of this market—excluding the U.S.S.R.—will be with non-U.S. carriers. The dynamic environment of this marketplace is characterized by the rising costs of fuel and labor and by reduced regulation of service patterns.

To answer future demand for aircraft, U.S. companies are offering a mix of new designs—for example, Boeing B-757 and B-767 and Douglas DC-9-80—and advanced derivatives—B-737-300—incorporating the most advanced technology to meet various range and size requirements.

Nonetheless, Europe's Airbus Industries' competitive model A-310 will soon enter airline service, and another version, the A-320, is waiting in the wings, as are other Airbus products. Obviously the stakes are high.

Despite the richness of the game, however—or perhaps because of it—we would welcome such a competitive contest wholeheartedly were it to be decided on quality of product. Unfortunately, our foreign competitors enjoy an advantage over us in terms of marketing—their Government-subsidized financing mechanisms. The economies and national prestige of the parent countries of our largest and most effective rivals have been tied, in part, to the success of their aeronautical industries, and these countries are more than willing to pay for that success.

The result has been highly aggressive financing practices, which, combined with a self-inflicted wound—the deliberate undermining of America's financing institution, the Export-Import Bank of the United States by the U.S. Congress and the administration—have been most effective in luring sales out from under the noses of the American manufacturers.

I must admit that we in industry have been mystified by the current attitude toward the Eximbank. On one hand, the administration calls for a strengthened economy, and certainly beefed-up foreign sales would contribute toward that end; but, on the other hand, they enthusiastically advocate gutting their most effective export-promotion entity. The cost of the Eximbank is minimal compared with the export-related benefits therefrom, including Federal, State, and local tax revenue, social security contributions and reduced unemployment benefits which would not have been possible without Bank-financed exports. Almost all of its outlays are returned to its coffers. We have told this story time and time again, yet the virtues of the Bank, which are so evident to those struggling in the marketplace on a day-to-day basis, seem strangely invisible to administration theoreticians.

Therefore, although we intend to continue to fight for what we believe to be a sensible and farsighted way of preserving U.S. aeronautical supremacy through judicious use of what is left of the Eximbank, we are realistic enough to recognize that aircraft financing worldwide has to change.

In our view, the OECD countries should adhere to commercial market rules. If the market will support 18 percent interest and an 18-year term for aircraft sales, that is what should be available in the way of credit. If the market terms are 7 percent and 7 years, then export credit should shift toward that end of the scale, also.

Recent shifts toward higher interest rates negotiated by France, the United Kingdom, Federal Republic of Germany, and the United States were commendable but are only temporary and limited in scope, and additional steps must be taken to bring export financing to market levels worldwide.

One possible solution would be to give export credit agencies access to capital markets throughout the world through commercial banks. The commercial bank could provide a portion of the funding directly, and longer maturities would be financed by placing the agency guarantee with the financial institutions through letters of credit. The resultant airplane finance package would reflect then available commercial terms, both rate and maturity.

Objective third-party measurements could be developed which would mean that the export agency guarantee fee would be a variable, acting in such a manner to insure that the foreign buyers receive a commercial rate based on their respective credit standings. In this manner, XYZ airline would have a rate of 2 percent over prime whether the purchase is for a DC-10, a Boeing 747, or an Airbus. The financing term and rate would be a factor of the then existing credit markets.

A key element in implementation of such a concept, which we feel deserves serious consideration, is an international equipment trust certificate. Commercial terms for export credit and the potential elimination of Government involvement might be accomplished through a trust vehicle, which is a well-established security instrument in the United States. Initially, export credit agencies would guarantee such certificates for private placement in the financial community.

In other words, the export credit agency would guarantee that the certificate holders, in the event of a default, would be paid off by repossessing the aircraft. Given some market experience and some development of documentation, we think the export credit agency could gradually reduce the level of its guarantee from a full commercial credit guarantee to a guarantee of the underlying security.

If this type of financing can be developed and agreement can be reached with our foreign competitors, we feel confident that commercial insurers will gradually come into the package. Given further development of international law, confidence in documentation standards. and some case law experience in airplane repossessions, the risk should be considered a commercial one which can be assessed by commercial barriers.

What happens is that by design, export credit agencies will begin to work themselves out of the aircraft financing business. All of these things are possible—possible, however, only if we act now to put aircraft commercial export credit back into the commercial marketplace. We have prepared a paper on the subject which we are leaving with you for your future examination.

We will be refining and revising this, trying to make it more easily understood as we go along.

However, the point I wish to make is this: While, granted, it is a different world and we are in a state of transition in some of these difficult and complex areas, we in the aerospace industry do not feel the situation is hopeless. Negotiations with our foreign competitors are ongoing and will probably yield some compromises.

Industry and Government are meeting together, as we are here today, and, it is hoped, will be able to apply their mutual intellectual resources toward a livable adaptation to changing conditions. As long as we are talking and innovating, we believe that progress will be made and the huge and all-pervasive benefits of the American aircraft manufacturing industry will continue to accrue.

I realize that I have concentrated exclusively on the commercial side of our business, Mr. Chairman. But I would be happy to address any questions you might have concerning military sales, either here, in person, or for the record.

Thank you very much.

I would also like to call your attention to a document that our research center has published, which I think is an excellent comprehensive coverage of the challenge of foreign competition, which is what it is called. It was completed by us a month ago.

With your permission, we will leave that with the committee as well.

[The document referred to follows:]

THE CHALLENGE OF FOREIGN COMPETITION

To the U.S. Jet Transport Manufacturing Industry

An Ad Hoc Study Project
of the
Civil Aviation Advisory Group
Aerospace Technical Council

A Publication of
THE AEROSPACE RESEARCH CENTER

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INTRODUCTION

When, in the mid 1970s, the Aerospace Industries Association of America (AIA) first prepared an analysis on The Challenge of Foreign Competition,[1] the United States was approaching the end of its second recession in five years, Japan was pulling out of its only recession in the past quarter century, and Europe was still in the midst of recession. Internationally, there was a mood of general pessimism with much talk of travel restrictions, trade protectionism, and a need to adjust to a steadily declining standard of living.

At that time, the U.S. civil aircraft industry was in a position of having about 95 percent of the world's orders for airliners (excluding Soviet production) but it also had the lowest backlog of orders in more than two decades. Over 7,000 aerospace workers had been laid off as the industry retrenched. The jet transport manufacturers faced cash flow problems; in fact, the yet unrecovered development costs of the latest wide-bodies (Boeing B-747, McDonnell Douglas DC-10 and Lockheed L-1011) exceeded the companies' net worth. Meanwhile, the governments of France, Germany, Japan, and the United Kingdom were increasing support of their domestic aircraft manufacturers and moving toward transnational joint ventures in aircraft production.

The AIA analysis concluded by noting a need for:

- A healthy and vigorous U.S. domestic economy capable of generating an increased demand for air transportation and sufficient new U.S. airline orders to maintain cost competitive prices,
- Long-term financing for both U.S. and foreign airlines to facilitate aircraft purchases,
- A world trade environment in which U.S. manufacturers would have equality of marketing opportunity, and
- Government and industry investments in R&D to improve the aeronautical technology data base.

Since that time, some improvements in these areas have been experienced. New impediments for the industry, however, have been growing at a fast pace.

Current Situation

When the decade of the seventies ended, the U.S. aircraft industry was in a very different and overall improved financial situation from that of the mid-seventies. Sales and exports were strong; in 1980, the current dollar backlog of orders was nearly three times that of 1975, and employment was higher than at any time since 1969. Moreover, a favorable new code of conduct for marketing civil aircraft worldwide had been implemented through the 1979 Agreement on Trade in Civil Aircraft, part of the General Agreement on Tariffs and Trade (GATT).

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The U.S. commercial jet transport industry still leads in sales to the world market but foreign manufacturing industries are taking an increasingly significant share. Shown here, the McDonnell Douglas DC-9 production line.

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[1] Aerospace Industries Association, *The Challenge of Foreign Competition*, (Washington, D.C., 1975).

The A-300 is produced by a European consortium of nations with strong financial commitments to the survival of their aircraft industries.

At the same time, the industry has not been immune from the economic trauma suffered by most of the major industrial countries and the outlook is hazy. After six years of strong economic growth—when demand for airline passenger services and for air freight increased 50 percent—the industrial counties as a whole anticipate only moderate economic growth. The near-term demand for air service and for new jetliners has had a dramatic decline and foreign competition has strengthened. While foreign competition accounted for less than 5 percent of aircraft orders during the period of the earlier AIA study (1974–75), Airbus Industrie orders in 1979 represented 30 percent of the total market. The European success has depended, in no small measure, on the active political and financial support of the governments of France, West Germany, and the United Kingdom.

Today, export financing has become the decisive factor in many world market competitions. Private capital is both scarce and expensive, complicating the situation for manufacturers and potential buyers of commercial jet transports. Foreign collaboration on aircraft production has become an increasingly appealing option when capital, technology and marketing assistance are readily available from foreign governmental institutions which emphasize high-technology industry development.

The Future

The anticipated demand for new jetliners over the next decade will be between 4,000 and 5,000 airplanes (or approximately $125 billion in 1980 dollars). A similar demand ($100–$150 billion) is forecast for 1990–2000. About 60 to 65 percent of this market (excluding the USSR) will be with non-U.S. carriers. The dynamic environment of this marketplace is characterized by the rising costs of fuel and labor and by reduced regulation of service patterns. The 1981 air traffic controller's strike has added another dimension of uncertainty.

To meet this demand, U.S. companies are offering a mixture of new designs (e.g. Boeing B-757 and B-767) and advanced derivatives (DC-9-80, B-737-300 and L-1011-500) incorporating the newest, advanced technology to meet various range and size requirements. Europe's Airbus Industrie's competitive model A310 will soon enter airline service and another version, the A320, is about to be launched.

Capital commitments and associated costs for all manufacturers now launching new aircraft models are staggering and the number of unit sales required to reach program profitability is greater with each new generation. The U.S. aerospace industry's profit per sales dollar continues to be less than the average for all manufacturing industries. The future profitability of the industry is in serious question, in part due to the increasingly competitive environment.

Competition is essential in a free market society to ensure the best products at the lowest cost. In today's world, however, civil aircraft competition is sometimes influenced by more than just the free market selection process. Foreign companies and programs have been continued by government supports that perpetuate marginal programs. Some new programs have been started more as a matter of national requirements (e.g. pride and employment) than for profit. This policy can lead to major financial hardships for U.S. private industry, since it must compete against national governments, as opposed to profit-oriented enterprises. Nonetheless, U.S. aircraft manufacturers must either invest heavily in new aircraft model production or suffer a slow death from product obsolescence as foreign suppliers strengthen their capabilities.

A key question facing the worldwide aerospace community today is not "How many suppliers of jet transport aircraft are needed to meet the demand?" but "How many different manufacturing entities, each competing for a favorable share of a finite market, can the world airline industry support?" The civil jet transport industry may well be at a crossroads. Faced with the economic realities of severe market swings, large numbers of sales needed to break even, overcapacity and fierce competition, several provocative questions await answers. Is the industry destined to further politicization in the years to come? Will public funds continue to be committed to support civil jet programs or will the natural forces of free enterprise be permitted to shape the industry into a self-sustaining and profitable one?

For the United States, the question is: "How is the U.S. aircraft industry likely to fare in the highly competitive environment of the eighties?"

CONCLUSIONS

- U.S. aircraft and engine manufacturers have dominated the world market since the introduction of the commercial jet transport, but with the emerging success of the European Airbus program, this leadership is being challenged. General aviation and helicopter manufacturers are also feeling the pressure of increasing competition by rapidly developing foreign aeronautical industries.

- The United States' effort to maintain its lead in the international transport market is made more difficult by the increasing capital, marketing and political risks of committing a modern commercial jet transport to production. Unfortunately, for U.S. manufacturers, the means to minimize risks are fewer than for manufacturers abroad, due to differences in economic systems, national priorities and business/government relations. The U.S. commercial transport industry is functioning in a world trading environment increasingly characterized by the national promotion and subsidization of exports.

- The commercial jet transport is one of a waning number of examples of American technological superiority. Still, foreign R&D capabilities have expanded rapidly while overall aerospace industry R&D funding, in constant dollars, declined from the late sixties through the mid-seventies and has not again reached the levels of the sixties. The U.S. aircraft industry's technological leadership is in danger of erosion and, as a result, the industry's competitiveness has become more sensitive to export financing and other aspects of government policy.

- Fulfillment of the Civil Aircraft Agreement, concluded in the Tokyo Round of the General Agreement on Tariffs and Trade, is essential to an improved trading environment, as are amendments to meet changing world trade conditions. The problems of implementing the agreement will not be resolved without industry and the U.S. government working together. The government is moving slowly to respond to information and policy recommendations provided by the Industry Sector Advisory Committee.

- Major financial incentives offered the aircraft industry by the U.S. government to expand export marketing include some funding of basic research and development, the Domestic International Sales Corporations (DISCs) and the Export-Import Bank. The survival of DISC is in question, as it is under attack both abroad and in Congress. Export-Import Bank financing, upon which aircraft export sales have relied heavily, is also endangered by Administration and Congressional criticism. Unless U.S. civil aircraft manufacturers can provide export financing comparable to foreign government offerings, they are economically disadvantaged in international competition.

- Export disincentives include administrative delays, unilateral export controls for foreign policy reasons, and the uncertainty caused by antitrust legislation and the Foreign Corrupt Practices Act. When not shared by the foreign competitor, such disincentives tend to disadvantage U.S. exporters and provide unwarranted sales opportunities for other nations.

- In the last few years, the restructuring of the competition, changes in the world marketplace for civil aircraft, and the enormous cost of new programs have caused collaborative relationships to develop between U.S. and foreign companies. Aircraft companies will continue to enter into such agreements in order to acquire market share, diminish risk, expand, or simply survive. Although technology transfer is a source of concern and constraint, acceptable controls will evolve within the industry and be applied without disrupting the careful balance required of transnational relationships.

- Although several major aerospace companies are involved in foreign partnerships to some degree, foreign competition continues to be an issue of significant concern. The industry's importance to national security and the U.S. trade balance dictates that the nation work to assure its continued strength. It must:

  — Support research and development policies that will assist high-technology industries to maintain their competitive edge.

- Maintain a strong trade position by seeking the fullest possible benefits from trade agreements, by providing incentives to export and removing disincentives, and by working to make export credit financing a neutral element in the competition for world markets.

- The United States cannot afford to assume its dominance in the important world aircraft market will continue without effort.

RECOMMENDATIONS

The foreign challenge to the market domination of U.S. civil jet transport manufacturers is real. In order to meet it, both the U.S. government and industry must renew efforts to keep the aircraft industry technologically and economically competitive.

Government

Financing

- Increase the Export-Import Bank's lending and guarantee authority so that it can provide assistance to exporters consistent with the terms and interest rates offered by foreign governments.
- Work to make export credit financing a neutral element in the competition for world markets by: elevating export credit agreements to the status of a multilateral treaty within the Organization for Economic Cooperation and Development; establishing an international agreement that would result in longer-term financing at market rates; encouraging innovative alternatives to subsidized export financing—alternatives such as an international equipment trust.

Research & Development

- Establish a long-term national R&D policy to be developed jointly by the Executive Branch, Congress and private industry. The policy should be based on a government/industry partnership concept, reflect a national perspective by setting broad goals for the development of U.S. industrial sectors, and stress a balance between government, academic and industry-related research and development.

Incentives

- Establish exports as a high national priority
  - Promote and actively seek broader acceptance—by the federal government, industry, organized labor and the public—of the beneficial relationship between increased exports, more jobs and a healthy economy.
  - Develop export strategies and programs for those industry sectors capable of large export growth.
- Retain the benefits of the DISC program or provide similar benefits in a program that will be consistent with the terms of international trade agreements.
- Insure adherence on the part of signatory nations to the Multilateral Trade Negotiation Agreements and act, if necessary, against tariff or non-tariff barriers imposed by other nations in violation of the Agreements.

Disincentives

- Alleviate the uncertainties created by the disincentives of U.S. antitrust laws, boycott strictures, and the Foreign Corrupt Practices Act, with a negative impact on export efforts.
- Repeal foreign policy export controls targeted specifically to civil aircraft.

Industry

- Work with all aircraft manufacturers and private financial institutions worldwide to develop the mechanisms by which aircraft purchasers can achieve longer-term financing.
- Work with the U.S. government in monitoring adherence to the GATT agreements and OECD Finance Agreements.

EXECUTIVE SUMMARY

At one time, commercial aircraft sales were made simply on the basis of the best price and the best product, the latter measured in terms of aircraft economics, quality, support and delivery schedules. While these things are still important today, the sale of commercial transports in the world market now also depends upon various political and economic factors that stem from worldwide events and trends of the past five-seven years. Among them:

Worldwide economic recession of 1974–75—During the recession, world airline passenger traffic growth slowed, and U.S. airlines experienced no traffic growth at all. Worldwide orders for new aircraft dropped from an average of about $6 billion per year to around $3 billion for 1974–75.

Accelerating fuel prices—Airline fuel costs rose from 18 percent of total operating costs in 1975 to 31 percent in 1980 with a negative impact on operating earnings. Air travel prices were forced higher and, consequently, traffic declined. Fuel prices have added to inflation and today's higher interest rates are making it difficult to finance the purchase of new aircraft and, as a result, pressure has been placed on governments to aid in the financing of aircraft for exports. At the same time, higher fuel prices have increased the need for more fuel-efficient aircraft, and accelerated retirement or retrofit of less fuel-efficient planes.

Decline in U.S. productivity—Since 1975, U.S. productivity has grown only 4.3 percent, while in other leading industrial nations it has increased from 10 to 25 percent. This has heightened the importance of highly productive industries. U.S. commercial transport manufacturers have maintained a high level of productivity through economy of scale as a large overseas market, and large domestic market, have permitted large production runs.

U.S. domestic policy—Legislation deregulating U.S. airlines has led to a dramatic increase in airline fares to cover rising costs of fuel and labor, and to a rapid restructuring of most airlines' route systems. In particular, the larger carriers have released less profitable short-range routes, on which they were flying relatively large equipment, creating a void in the short-range commuter market.

U.S. defense and foreign policy—The modest defense procurement and R&D increases of the late seventies have taken their toll as military technology had long been a significant ingredient (now decreasing in importance) in the formula for U.S. superiority in the commercial transport business. Additionally, Congress and the Executive Branch have made strong efforts to limit the export of military goods and imposed controls on shipments of commercial transports to certain countries for foreign policy reasons.

The Multilateral Trade Negotiations—The Tokyo Round of the Multilateral Trade Negotiations (MTN), concluded in 1979, established a new framework for fair and equal trade policy among nations. The Civil Aircraft Agreement, if realistically implemented, has the potential of normalizing the lopsided balance generated by foreign government influence that is now so important in the sale of commercial transports internationally.

The U.S. in world affairs—Beginning with the trauma and frustration of Vietnam, the United States has experienced a series of image losses at home and abroad which can be seen as a weakening of U.S. posture in relation to other major powers.

All of these events and trends form a background against which to view the important role of exports in the U.S. economy, and the United States' changing world trade position. While exports as a percentage of U.S. GNP have increased from 4.3 percent in 1970 to 8.2 percent in 1979, U.S. exports as a percentage of total world trade have declined from 15.2 per cent in 1970 to 11.9 percent in 1980. This is due in part to the change in comparative economic advantages among nations but also to the slow awakening of the U.S. government to the need to promote exports.

While the export performance of U.S. industry in general has been less than outstanding, the commercial aircraft sector has made a strong contribution to trade balance. Since 1970, civil jet transport deliveries and sales of spare parts have resulted in a net surplus of exports over imports. In 1979, the industry was producing the largest trade surplus of any American manufacturing industry. In that year, and again in 1980, an aerospace firm was the nation's largest single exporter; in fact, five of the top ten exporting companies were aerospace firms.

World Economic Outlook and the Market for Commercial Transports

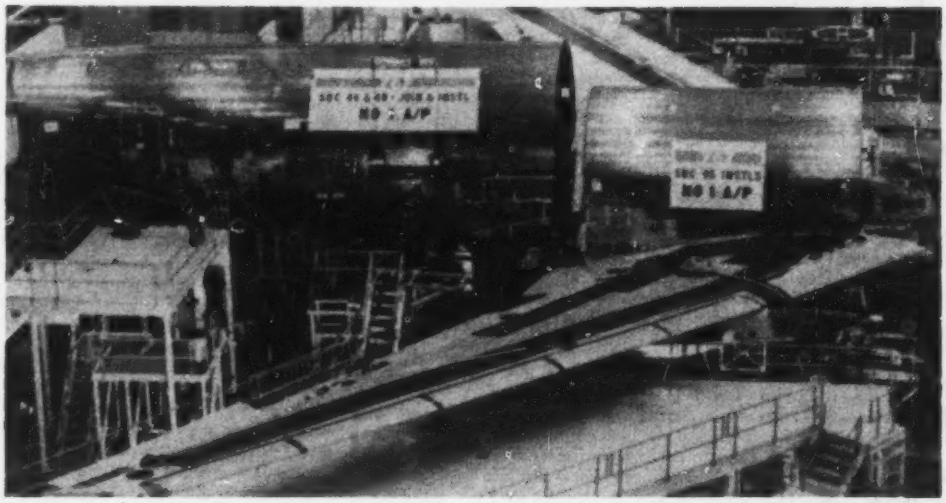
The nations of the world are experiencing a reduction of economic growth and even with improvements expected in the long-term, world real GNP growth should be less than that experienced historically. The United States and Europe will average around 3 percent growth while the rest of the world will average closer to 5 percent. Based on growth forecasts and a number of assumptions about the world economy, transport aircraft manufacturers regularly assess the world aircraft market. Although each manufacturer's assessment varies somewhat from the others, the value of the aircraft to be delivered during the eighties, in today's dollar, is expected to be between $110 and $140 billion.

The U.S. industry, however, faces strong competition for that market. It can no longer claim 90 percent of the world aircraft market as it did for 15 years prior to 1979. In 1979, the European consortium, Airbus, received 31 percent of wide-body orders placed. In 1980, Airbus achieved 32 percent of orders placed and, as of September 1981, held 43 percent of the world wide-body backlog. There is every reason to believe growth of non-U.S. jet transport manufacturing and marketing will continue. The largest forecast growth in travel demand, moreover, is outside the United States and this could prove an asset to foreign manufacturers.

Risks Involved in Civil Aircraft Production and Marketing

The strong foreign competition experienced by the industry greatly increases the already high risks of committing to production of a modern jet transport for commercial markets. Capital risks in the jet transport industry are extremely high; since jet transport technology was introduced into commercial service, the ratio of program launching costs to equity has always exceeded 1.3 to 1.0. Billions of dollars in pre-production commitments are required in the design, subcontracting, tooling, marketing and certification stages of aircraft production. Most of these costs are not recoverable for years—typically 10 to 15 years. Moreover, few jet transports have sold in sufficient numbers in the dynamic markets of the last 25 years to have earned a profit for their makers or the governments that sponsored them.

There is an enormous uncertainty involved in new aircraft introduction because many factors significantly affect the model's acceptance and the manufacturer's return on initial investments. However, the larger the marketplace, the more likely a program is to be successful. And the wider the product line, the greater the market for a particular manufacturer, and the more flexibility to meet planned and unplanned demand changes. The loss of opportunity to compete in the market increases the risk of the total program and, for that reason, initial sales of particular jet transport equipment to each single customer are critical. The loss of an initial sale to an airline will likely result in the loss of that carrier's market—for that size aircraft—for 15 to 20 years. It is also true that initial sales success or failure with a particular regional airline can influence the decisions of other carriers in that market. A recent example is Airbus penetration of the Silk Route market which encompasses the Pacific Rim, Asian subcontinent and Arabian Gulf



The commercial transport industry faces enormous risks in committing to production of a modern first-generation airliner such as the Boeing 767.

Government involvement is a particularly important factor in new aircraft introduction. The manufacturing and marketing of U.S. commercial jet aircraft have been financed over the years in a free enterprise system in which private capital flows to commercial ventures with the potential to protect and multiply that capital. Many foreign manufacturers, however—such as Fokker, Airbus Industrie, and British Aerospace—have received at least part of this funding from their national treasuries. Because of fundamental differences between the U.S. economic system and those systems of its competitors, the means available to minimize the risks of an aircraft program undertaking are significantly different.

Increasingly, the risks involved in aircraft manufacturing involve political as well as capital and marketing concerns, and these are closely identified with differences in national priorities. The priorities of the European and Japanese governments include financial support to industries designated as important to the future of the country. These nations are less concerned with return on investment from a company point of view than on overall national return such as employment, and development and perpetuation of a high-technology aircraft and aerospace industry.

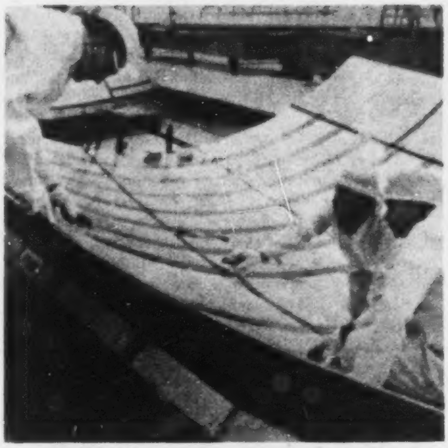
In the United States, trade restraints to promote foreign policy objectives are an increasingly common form of political risk for private industry. As these policy objectives are often not supported by other developed nations, the United States is, in effect, abandoning a particular marketplace to other countries.

Still other political risks center on financing terms, now a pivotal item in sales to non-U.S. carriers. The inflation-caused limitations on private U.S. banking institutions, combined with funding constraints on the U.S. Export-Import Bank, are denying U.S. exporters competitive equality, given the national treasury support of their aircraft industries by the nations of the European Economic Community.

Government Support of Aircraft Exports

The national promotion of exports has clearly emerged as a significant factor in world market competitions. Export credit financing and insurance, tax avoidance or reduction incentives, direct promotion, bilateral agreement negotiations, and direct financial assistance are increasingly common. The commercial jet transport industry has become a high priority for export support among industrialized nations—so much so that, until recently, a virtual export credit war was underway.

U.S. efforts to bring export financing in line with current market conditions had stalled through December 1980 in the face of tough opposition to change by the French. Then in 1981, the United States, France, West Germany and Britain concluded an interim arrangement covering Airbus and U.S. aircraft which established minimum interest rates (U.S. dollar—12 percent; French franc—11.4 percent; German deutsche mark—10 percent) and limited the cover to 42.5 percent for Eximbank type credits and 62.5 percent for European credits. (Average term of loan is equivalent because of different repayment requirements.) Participation in excess of the 42.5 percent on Eximbank financing would be limited to guarantees. This interim agreement, like the Standstill Agreement entered into by aircraft-exporting nations in 1975, continues the repayment term at 10 years.



Jet transport production provides jobs not only in the aerospace industry but throughout the economy.

The Role of Research and Development

U.S. commercial jet transport manufacturers are working hard to maintain their competitive position in the world market. They have committed billions to introduce new and improved, fuel-efficient models in several market areas. Similar commitments of funds have been made by aircraft engine manufacturers. The aircraft manufacturers represent a bright spot in U.S. industrial productivity and have been able to modernize and expand production capabilities. As a result, the U.S. commercial transport aircraft is still a sound competitor in fuel efficiency and price—when price reflects real cost. Nonetheless, the expansion of foreign R&D capabilities—much of it funded by the governments involved—is challenging U.S. leadership and, in some cases, foreign developments are outpacing U.S. programs. Because of this, the U.S. industry's competitiveness has become much more sensitive to export financing and other aspects of government policy.

U.S. Export Incentives and Disincentives

The U.S. government offers incentives to exporters including (1) promotional programs, (2) assistance to small and minority-owned firms, (3) the improvement of trading opportunities through international trade agreements, and (4) financial incentives. Commercial jet transport and related supplier marketers can find assistance only in the last two categories.

U.S. negotiators were particularly aggressive on behalf of aircraft exporters during the Tokyo Round of the General Agreement on Tariffs and Trade. The fruit of their efforts was a Civil Aircraft Agreement among 14 nations eliminating import duties on civil aircraft and most related parts, as well as a variety of non-tariff barriers to free and competitive trading opportunities. Signatory governments also agreed that aircraft prices should be based on a reasonable expectation of recoupment of all costs and, further, that governments should not require nor exert unreasonable pressure on airlines, aircraft manufacturers or other entities engaged in the purchase of civil aircraft, to procure civil aircraft from any particular source. It is nonetheless true that the governments of Airbus Industrie participants still have a wider range of marketing opportunities available to them, due to the close relationship in those countries of political and commercial interests.

When the Civil Aircraft agreement went into effect, the United States immediately eliminated a 5 percent duty on most aircraft-related imports. Concessions by other signatories were related more to non-tariff issues, and the U.S. aircraft industry anticipates some substantive difficulties over unresolved matters, as well as over questions of interpretation of the Agreement.

Financial incentives that assist civil aircraft industry exports are limited to the Domestic International Sales Corporations (DISCs), Export-Import Bank financing, and some funding of basic research and development. The future of the DISC as an export incentive is in doubt due to Congressional criticism of the allowed deferral of taxes on foreign sales income and a concerted effort by EEC countries through the GATT to eliminate DISC benefits.

The current high cost of funds to the Export-Import Bank and the below-market-rate offerings of foreign export credit agencies have endangered the standing and capability of this favorable export incentive. Moreover, this type of financing, while not particularly troublesome to foreign governments, is a controversial issue in the U.S. Congress.

U.S. aircraft export sales have relied heavily upon Eximbank financing in recent years. A small fraction of a percentage difference in export financing can make a significant difference in the total operating cost of a jet transport over the period of a loan. U.S. capital costs have risen precipitously in recent years and, as a result, U.S. manufacturers are at a serious disadvantage when competitive foreign export financing programs, providing fixed rates, are compared to U.S. export financing programs, which include commercial bank fluctuating rates combined with Eximbank fixed rates. With the prime rate above 15 percent, the difference between a foreign competitive fixed rate offer at 8¼ percent and a U.S. blended rate could range between 300 and 400 basis points. For a 10-year loan, this translates into additional capital costs of between $15.8 to $26.3 million for each $100 million of financing.

In the course of shopping for future fleets, customer airlines are looking at total operating costs, including debt financing and its service costs. U.S. jet transport makers have been economically disadvantaged in an otherwise open competition unless export financing comparable to foreign government offerings was available from Eximbank. Even recent agreements on minimum interest rates do not guarantee parity to U.S. firms.

The aircraft industry has also encountered active disincentives to export including administrative delays and unilateral export controls for foreign policy reasons. In addition, while antitrust laws are not themselves credited with many lost export opportunities, the uncertainty caused by their interpretation and application, combined with the burden of antiboycott strictures and the Foreign Corrupt Practices Act, tends to disadvantage exporters and provide sales opportunities for other nations.

ALL NIPPON AIRWAYS

Exports of jetliners such as the Lockheed L-1011 have depended heavily on Eximbank financing.

Emerging International Collaboration

In the last few years, with the restructuring of competition in the aircraft market, changes in the world marketplace and increases in program costs, some U.S. aerospace companies have entered new relationships with foreign companies. These U.S. firms have made collaborative agreements with foreign firms to gain market share and decrease financial risk. In fact, it must be noted that approximately one-third of the Airbus A300 is of U.S. manufacturing content.

In some instances, countries are using cooperative relationships as a means of acquiring advanced technology capabilities. Transborder partnerships also permit the sharing of costs of research and development, of launching engine and airframe programs, and of supporting production facilities. They can minimize political risk and provide improved access to markets that were previously unavailable or restricted. U.S. manufacturer involvement in international agreements has been encouraged by attitudes, policies and laws of the United States that inhibit exports. Further, the Department of Defense has promoted the trend through collaborative weapons production agreements in the interest of cost reduction and of hardware commonality with NATO nations.

Increasingly, U.S. firms have found that in order to participate in the international defense market, they must collaborate with foreign companies, many of which are either owned or strongly influenced by their governments. For U.S. manufacturers, "offset" required by foreign governments has frequently become an integral part of selling efforts. Offsets consist not only of the seller's buying foreign products to partially offset his sales—and, therefore, to offset the balance of trade gains—but may also involve the manufacture, under license, of part or all of a seller's product within a foreign buyer's country.

While technology transfer is a concern in these cooperative relationships between countries, there is every reason to expect that active transnational cooperation in the aircraft industry will continue. There is a need for caution, however, in considering this trend and drawing inferences about the nature of the aerospace export market. Transborder relationships will change with time and those who are partners today will not necessarily be partners tomorrow. In addition, not all major U.S. aerospace companies are involved in foreign partnerships to the same extent. Foreign competition remains an important issue for an industry in which rival firms and nations risk very high stakes for a limited number of commercial aircraft sales.

Turn to page 69 for a detailed look at the rapidly expanding aircraft capabilities of other nations.

THE OUTLOOK FOR THE WORLD ECONOMY AND THE COMMERCIAL JET TRANSPORT MARKET

A particular concern of this report is that the sales of commercial aircraft are no longer simply a function of price, aircraft economics, quality, support and delivery schedule, but are dependent upon other factors as well—factors that stem from issues and problems confronting the world political and economic systems. Some of the more salient of these worldwide political and economic events and trends in the past five years, and their direct or indirect impact on the commercial transport industry, are presented in Figure 1 and discussed below.

Worldwide economic recession of 1974 and 1975—Most of the developed countries did not experience real economic growth in the 1974–1975 period. In the United States, where about one-third of passenger air traffic is generated, the economy actually declined in real terms. The greatest impact on the commercial air transport industry was the stagnation of growth in traffic and the corresponding reduction of orders for new aircraft. World passenger traffic, which had been growing 12 to 13 percent per year in 1972 and 1973, was reduced to 3 to 5 percent growth in 1974 and 1975. The U.S. airlines were most affected and experienced no traffic growth in the recession years. Worldwide orders for new aircraft dropped from an average of about $6 billion dollars per year to around $3 billion dollars for the years 1974 and 1975.

Accelerating fuel prices—The rise in fuel prices, by nearly a factor of seven in current dollars since 1975, has continued to shock almost every aspect of the world political and economic systems. More specifically, it has affected the commercial transport industry in many ways.

The rise in fuel prices, for example, has substantially increased airline operating costs. In the United States, fuel costs have risen from 25 percent of direct operating costs in 1974 to 57 percent in 1980. Not only has this had a negative impact on operating earnings but it has forced air travel prices higher and, consequently, has had a negative impact on travel.

Fuel prices have added to inflation and today's higher interest rates are making it difficult to finance the purchase of new aircraft. As a result, pressure has been placed on governments to aid in the financing of aircraft for exports.

Importantly, higher fuel prices have forced nations to stress exports in order to balance the accelerating costs of importing oil and the increased need to export has produced a tendency among nations to limit imports or lean toward protectionist attitudes. In the case of the balance of trade between the United States and Europe, the United States has been running a surplus, thereby increasing the need for Europeans to export. Obviously, for Europe as for the United States, the export of commercial jet transports is hardly insignificant with respect to improving the balance of trade. Those nations that have real difficulty in increasing exports, yet must continue to import fuel at higher prices, can only increase their debt or reduce their standard of living. A choice to increase the level of debt will only add to world monetary problems and a reduction in the standard of living has a negative effect on the purchase of commercial transports and all other goods.

One of the more direct impacts of higher fuel prices on the commercial transport industry has been the emphasis now placed on research and development to improve aircraft fuel efficiency. The need for more fuel-efficient aircraft has already changed the character and timing of proposed new aircraft programs.

Still another effect of higher fuel prices is on the retirement of older, less fuel-efficient aircraft and on the retrofit of older aircraft with new engines. It is estimated that over half of the aircraft in the world fleet today will be out of service by 1990.

Decline in growth of U.S. productivity—Productivity stands out as a significant economic factor in the United States in 1980, and there is seemingly general agreement that government policy should be directed toward improving it. Since 1975, U.S. productivity has grown only 4.3 percent, and this low rate of growth has occurred in a period of economic recovery from the most severe recession since World War II. During the same period, productivity increases in West Germany were 17.7 percent; and France, 15.1; Italy, 15.9; United Kingdom, 10.4 and Japan, 24.6 percent.[1] Scholars on the subject conclude the U.S. government should give increased attention to productivity in order to improve competitiveness in world markets.

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[1] Office of Industry Productivity Studies, Bureau of Labor Statistics, U.S. Department of Labor

The decline in U.S. productivity growth overall has heightened the importance of highly productive industries. U.S. commercial transport manufacturers have maintained a high level of productivity through economy of scale as a strong overseas market—and large domestic market—have permitted large production runs.

U.S. domestic policy—Legislation deregulating U.S. airlines has led to a dramatic increase in airline fares to cover rising costs of fuel and labor, and to a rapid restructuring of most airlines' route systems. In particular, the larger carriers have released less profitable short-range routes, on which they were flying relatively large equipment, creating a void in the short-range commuter market. Deregulation has caused manufacturers to re-think their opportunities for producing existing and future types of aircraft.

U.S. defense and foreign policy—In the five years preceding 1981, while the Soviet Union has continued to build up its military procurement and research and development activities, the United States has made only modest increases in defense procurement and military research and development expenditures. In constant dollar terms, defense budgets have been well below those of the sixties and early seventies. This period of decline has taken its toll on commercial transport development since military technology had long been applied to commercial transport development and been a significant ingredient (now decreasing in importance) in the formula for U.S. superiority in the commercial

FIGURE 1

THE WORLD ECONOMIC AND POLITICAL ENVIRONMENT AS IT BEARS ON THE COMMERCIAL TRANSPORT INDUSTRY

Events and Trends	Impact
☐ Worldwide Economic Recession of 1974–75 ☐ Accelerating Fuel Prices	☐ Dampened industry business volume.
	☐ Increased airline operating costs.
	☐ Reduced airline operating earnings.
	☐ Increased ticket price.
	☐ Decreased air travel.
	☐ Made the financing of new aircraft more difficult.
	☐ Stimulated foreign countries to increase exports.
	☐ Promoted protectionist attitudes.
	☐ Reduced standard of living in oil importing countries, reducing travel and purchases of aircraft.
	☐ Stimulated R&D to improve fuel efficiency of commercial transports.
	☐ Accelerated the retirement of inefficient aircraft.
☐ Decline in U.S. Productivity	☐ Prompted recognition of the need to adopt policies to strengthen U.S. industry and particularly the more efficient ones such as the aircraft industry.
☐ U.S. Domestic Policy	☐ Promoted competition through airline deregulation, changing network structure, introducing more uncertainty into size and number of transports for specific markets.
	☐ Provided wider freedom in structure of airline fares.
	☐ Instituted regulations to ensure quieter aircraft, prompting aircraft retirement and increasing the cost of air travel.
☐ U.S. Foreign Policy	☐ Imposed disincentives for U.S. aircraft manufacturers interested in promoting foreign exports.
☐ Infusion of Technology Worldwide	☐ Shifted countries' emphasis to higher technology, knowledge-intensive industries such as civil aircraft.
☐ The Multilateral Trade Negotiations	☐ Provided the framework for fair and equal civil aircraft trade policy.

transport business. At the same time, Congress and the Executive Branch—out of concern that arms transfer has become an automatic, unregulated process—have made strong efforts to limit the export of military goods and applicable technology from the United States.

A more direct impact on U.S. commercial transport exports stems from U.S. foreign policy to counter international terrorism and involves the imposition of controls on shipments of commercial transports to some countries in North Africa and the Middle East. Without judging the merits of the policy, it must be realized that much of the demand in those regions is being satisfied by non-U.S. suppliers, and that these export controls represent a large dollar loss to U.S. aircraft exporters.

The infusion of technology worldwide—As international trade has grown, transnational companies have been infusing technology and production processes in many parts of the world, particularly in the advanced developing countries such as Korea, Hong Kong, Taiwan, Singapore, Brazil and Mexico. As the capabilities of those countries increase, they become competitive in industries once dominated by the now developed countries. This process has created the need for the developed nations to specialize in areas where they can be more efficient; often this means being less labor-intensive and more technologically-intensive. As a direct consequence of the technology infusion process, other countries are now increasing their aircraft industry capabilities. The Japanese government, in particular, is reducing its support for such industries as steel and shipbuilding and increasing support in other areas, such as aircraft manufacturing. Japan has declared, as part of its long-range policy, its intention to grow in the commercial transport business.

The Multilateral Trade Negotiations (Tokyo Round)—By the conclusion of the Tokyo Round of the Multilateral Trade Negotiations (MTN) in 1979, a new framework for world trade had been established. The revised General Agreement on Tariffs and Trade mutually reduced tariffs among the signatories and, more importantly, made clear the conditions under which a non-tariff barrier such as a subsidy should operate. Included in the agreement was a special and separate Agreement on Trade in Civil Aircraft, which embodies the realization that trade policy and implementation among nations must be fair and equal. The Aircraft Agreement is significant because it has the potential of changing the nature of government influence, as it has recently evolved, in the export of commercial transports. The MTN agreements recognize that domestic subsidies, (e.g., government support for manufacturing in designated geographical areas, and interest-free loans and grants) are a proper matter of international concern because they have an impact upon foreign trade. The agreements in themselves, however, do not guarantee success in resolving the difficult and detailed non-tariff issues. It is essential to monitor compliance with the agreements and establish—and effect—a firm U.S. policy in the event of non-compliance.

The U.S. in world affairs—Following World War II, due to the devastation of much of the industrial capacity of the world, the United States was by far the strongest nation by any measure—military, political or economic. Since that time, however, Europe as a community of nations has risen to political and economic—though not military—parity. The Soviet Union, with an economy smaller than that of the United States, may have exceeded the United States militarily. Japan's standard of living has risen sharply and is approaching that of the United States.

While the United States is still the most prosperous nation in the world, it has become increasingly frustrated over events and trends beyond its borders. Many aspects of the daily lives of Americans—economic conditions, availability and cost of goods and services, even domestic policies—are strongly influenced by foreign actions or events over which the nation has little or no control.

The trauma and frustration of the Vietnam war and the departure of Americans from Vietnam in 1975 marked a turning point in U.S. influence in world affairs. Since 1975, the United States has experienced a series of image losses both at home and abroad which, looked at in broad perspective, can only be gauged as a weakening of U.S. posture vis-a-vis other major powers. To list some examples:

- The inability of the United States to control inflation.
- Nearly five years required for U.S. lawmakers to pass energy legislation, which may prove inadequate in the end.
- The Watergate Affair
- The 444 days necessary to retrieve the U.S. hostages from Iran and one spectacularly unsucessful attempt to rescue them.
- The trend of European allies toward neutrality, e.g.:
  - — Limited support by Europeans of U.S. policy on Soviet invasion of Afghanistan.
  - — Limited support of U.S. policy to sanction Iran for the takeover of the U.S. embassy and holding of personnel as hostages.
  - — French and German leaders' independent consultations with leaders of the Soviet Union.
  - — Stronger economic ties to Eastern bloc countries.
  - — Independent European monetary system.
  - — European supply of military and commercial goods to countries deemed off-limits by the United States for political reasons.
- The inability to protect U.S. interests in the Middle East, and provide citizen and investment security in the rest of the world.

All of these events and trends form a background against which to view the important role of exports in the U.S. economy, and the United States' changing world trade position.

World Trade and the U.S. Share

World trade in terms of volume of goods and services, has grown at an annual rate of 6 percent since 1953, and for most major industrial nations exports and imports are becoming an increasingly larger portion of gross national product (Table 1). For the United States, exports as a percentage of gross national product (GNP) have increased from 4.3 percent in 1970 to 8.2 percent in 1980. For the United States, however, exports are a lesser part of the total economy than for other industrialized nations; this lower ratio of exports to GNP is explained in part by the fact that the U.S. economy is itself larger than any other single national economy. Still, U.S. exports as a percentage of total world trade have declined from 16.1 percent in 1968 to 11.9 percent in 1980 (Table 2). Table 3 shows a similar decline in the U.S. share of world exports of manufactures since 1970. This is due in part to the change in comparative economic advantages among nations but also to the slow awakening of the U.S. government to the need to promote exports. On this point, the Joint Economic Committee of Congress stated that "The U.S. government acts as a naysayer to its own exporters by shackling them with a host of tax burdens, disincentives and restrictions, while the home governments of our world trade competitors act as coaches to their exporting firms."

U.S. technological competitiveness is strong in some areas and weak in others. Europe and Japan are competing with the United States on equal terms in areas such as iron, steel, machine tools, and non-ferrous metals, but lagging in computers and in some electronic components. The economies of Europe and Japan are promoting national industries, particularly those that offer the highest possible return. In the United States, the same kinds of government-support mechanisms do not exist and weaker industries often receive more government support than the stronger industries that could aid the economy through increased exports. As indicated

TABLE 1

RATIOS OF EXPORTS AND IMPORTS TO GNP[a]
OF U.S. AND LEADING INDUSTRIAL NATIONS
1970–1980

Year	United States	France	West Germany	Italy	United Kingdom	Japan	Canada
				Ratio of Exports to GNP			
	(Exports, f.a.s.)						
1970	4.3	12.7	18.4	14.2	15.9	9.5	19.6
1971	4.1	13.0	18.0	14.8	16.1	10.4	18.9
1972	4.2	13.4	18.0	15.6	15.6	9.5	19.1
1973	5.4	14.3	19.4	15.7	17.1	8.9	20.6
1974	6.9	17.3	23.4	19.5	20.1	12.0	22.0
1975	6.9	15.4	21.4	18.2	19.2	11.2	20.2
1976	6.6	15.8	22.6	20.0	20.8	12.0	20.1
1977	6.2	16.5	22.7	21.1	23.3	11.7	21.3
1978	6.6	16.0	22.1	21.4	22.7	10.1	23.2
1979	7.4	17.0	22.5	22.2	22.5	10.3	25.2
1980	8.2	17.8	23.4	19.8[b]	22.3	12.5	26.4
				Ratio of Imports to GNP			
							(Imports, f.o.b.)
1970	4.3	13.6	16.1	16.1	17.8	9.2	16.3
1971	4.6	13.5	15.9	15.6	17.3	8.5	16.5
1972	5.1	13.8	15.6	16.2	17.8	7.8	17.7
1973	5.6	14.9	15.8	19.8	21.7	9.2	18.9
1974	7.6	20.0	18.2	26.3	28.1	13.4	21.5
1975	6.4	15.9	17.8	20.1	23.2	11.6	21.0
1976	7.2	18.3	19.6	23.3	25.1	11.6	19.6
1977	7.8	18.3	19.5	22.4	25.8	10.4	20.3
1978	8.1	17.2	18.9	21.5	24.9	8.3	21.8
1979	8.7	18.7	20.9	23.9	25.5	11.1	24.1
1980	9.3	21.1	22.8	25.3[b]	23.2	13.6	23.9

SOURCE: Department of Commerce, International Trade Administration, *International Economic Indicators*. Figures for 1975–1979 revised as of September 1981.

[a] Exports are f.o.b. and imports are c.i.f. except as noted

[b] Preliminary

TABLE 2

WORLD EXPORTS AND U.S. EXPORTS AND U.S. EXPORTS AS PERCENTAGE OF TOTAL
1968–1980
(Billions of Dollars)

Year	World	U.S.	U.S. Exports as Percentage of World Exports
1968	215.2	34.6	16.1
1969	246.4	38.0	15.4
1970	283.5	43.2	15.2
1971	317.0	44.1	13.9
1972	37).1	49.8	13.2
1973	523.7	71.3	13.6
1974	772.0	98.5	12.8
1975	795.8	107.6	13.5
1976	906.5	115.0	12.7
1977	1,023.7	120.2	11.7
1978	1,193.8	143.6	12.1
1979	1,508.0	181.8	12.0
1980	1,846.0	220.7	11.9

SOURCE: International Monetary Fund, August 1981

earlier, labor productivity has increased much more slowly in the United States than in Western Europe or Japan. To some extent, the relatively poor rate of productivity increase in the United States can be traced to a relatively low rate of investment in plant and equipment and to restrictive tax laws; but low productivity can also be traced to the lack of emphasis on more efficient industries.

In recent years, there has been a tendency for many American industries to devote a smaller share of their research and development (R&D) expenditures to basic research, long-term projects, and technically ambitious R&D projects. According to data compiled by the National Science Foundation (NSF), U.S. R&D spending shrank from 3 percent of GNP in 1964 to 2.2 percent in 1978, while in most other industrial nations—with the exception of the United Kingdom—R&D spending as percent of GNP rose.[2] Recent NSF data indicated the R&D/GNP ratio has increased slightly each year since 1978 and should reach 2.4 percent in 1982. However, there is considerable evidence that, from an economic point of view, the United States has been underinvesting in technology. Many firms protest that some environmental, health, and safety regulations unnecessarily deter innovation. In many cases, companies have had to apply part of their R&D expenditures to satisfying these requirements. A reversal of the negative trend in R&D spending is essential to the United States' international competitive position, and the recommendations contained in a 1980 AIA study on research and development in the United States deserve thoughtful, but expedient action.[3]

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[2] *Science Resources Studies Highlights*, National Science Foundation, NSF 81-314, Washington, D.C., June 30, 1981.

[3] Aerospace Industries Association, *Research and Development: A Foundation for Innovation and Economic Growth*, (Washington, D.C., 1980).

TABLE 3

SHARES OF WORLD EXPORTS OF MANUFACTURES[a,b] OF U.S. AND LEADING INDUSTRIAL NATIONS
1970–Second Quarter 1980

Year	United States	France	West Germany	Italy	Netherlands	United Kingdom	Japan	Canada
1970	21.3	9.1	19.8	7.1	4.6	10.4	8.9	1.8
1971	19.7	9.3	20.2	7.3	4.9	10.9	9.9	1.4
1972	18.4	9.8	20.6	7.6	5.0	9.8	10.2	1.3
1973	18.0	9.8	21.8	6.8	5.3	9.0	10.4	1.1
1974	18.8	9.2	21.5	6.8	5.4	8.4	11.9	1.1
1975	19.2	10.2	20.1	7.3	5.1	8.9	11.4	1.1
1976	18.8	9.8	20.8	7.2	5.2	8.5	12.0	1.1
1977	17.3	9.9	20.9	7.7	4.9	9.2	12.6	1.0
1978	17.0	9.9	20.7	7.9	4.8	9.4	12.5	1.0
1979	17.4	10.7	20.8	8.3	4.9	9.5	10.8	1.0
1980(II)[c]	18.4	10.3	20.1	8.1	4.7	9.7	11.8	1.2

SOURCE: U.S. Department of Commerce, International Trade Administration, *International Economic Indicators* (various issues), as reported in "Study of U.S. Competitiveness," July 1980, Trade Policy Staff Committee, U.S. Department of Commerce.

a "World" is defined as the 14 major industrial countries
b Excluding exports to the United States
c Second quarter, 1980

While the export performance of U.S. industry in general has been less than outstanding, the commercial aircraft sector has made a strong contribution to trade balance. Since 1970, civil jet transport deliveries and sales of spare parts have resulted in a net surplus of exports over imports. By 1979, the industry was producing the largest trade surplus of any American manufacturing industry. In that year, and again in 1980, an aerospace firm was the nation's largest single exporter; in fact, five of the top exporting companies were aerospace firms. Over $7 billion in net exports were attributed to the commercial jet transport industry in 1979 and, in 1980, the net surplus was more than $9 billion. The benefits to the economy of the industry's positive export balance are widespread as, with each new program undertaken, individual airframe and engine manufacturers subcontract large portions of the end products to an extensive supplier network.

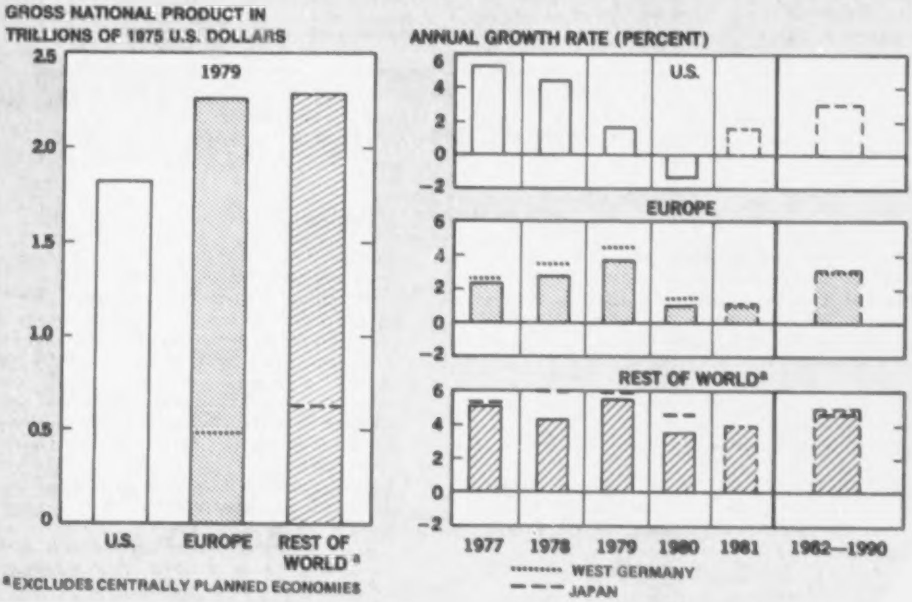
World Economic Outlook

The nations of the world are currently experiencing a reduction of economic growth rate. While recovery is expected for the industrialized nations in the next two years, the situation for less developed countries (LDCs) will likely worsen primarily because of their inability to service their increasing debt as a result of high inflation and large oil bills. In an effort to counter inflation, industrialized nations are pursuing more stringent monetary and fiscal policies. This would indicate a continuation of economic stagnation in the near term but, in the longer run, should improve the situation.

While improvements in the world economy should come about in the long term, it is nonetheless expected that world real GNP growth will be something less than has been experienced historically. The United States and Europe

FIGURE 2

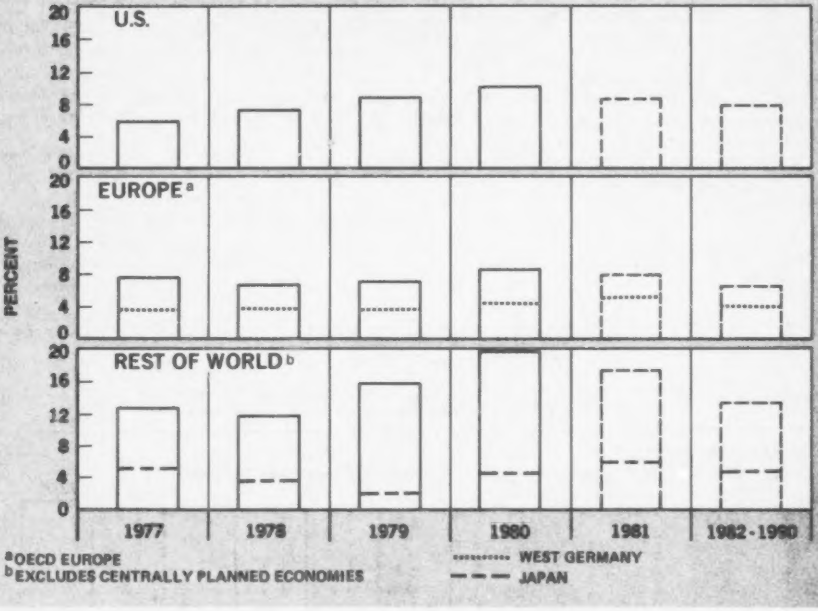
REAL GROSS NATIONAL PRODUCT AND GNP ANNUAL GROWTH RATE
FOR THE UNITED STATES, EUROPE, AND THE REST OF THE WORLD
1977–1990



a EXCLUDES CENTRALLY PLANNED ECONOMIES

FIGURE 3

GROSS NATIONAL PRODUCT INFLATION
FOR THE UNITED STATES, EUROPE, AND THE REST OF THE WORLD
1977–1990



should average around 3 percent growth while the rest of the world may average closer to 5 percent (Figure 2). Modest improvement in inflation is expected worldwide but inflation is still likely to range around 7 percent annually in the industrial countries. Notable exceptions are Germany and Japan, where inflation should be in the range of 4 to 5 percent (Figure 3).

Fundamental to a long-term forecast for the world economy are the following assumptions:

- There will be periods of economic downturn in the next 10 years.
- The OPEC cartel will endure and surplus receipts from oil revenues will continue to be placed in financial assets or precious metals, causing strains on financial institutions. OPEC recycling of petro dollars in the form of purchased goods and services, however, will continue to slacken.
- The debt servicing capabilities of LDCs will continue to weaken, and further strain financial institutions.
- Average growth of oil prices will range about 3 percentage points above the rate of U.S. inflation. Implicit is the assumption that there will be fluctuations in price growth rates but no major oil supply disruptions as serious as those experienced in 1973 and 1979. This assumption is one of the most critical to aircraft manufacturing planners yet, because of the highly political nature of oil price-setting, it is one of the most tenuous assumptions.
- The energy picture will improve in the latter part of the decade, through energy conservation and new technology developments.
- U.S. productivity will improve as a result of favorable incentives to business, incentives for personal savings, and prudent government spending.

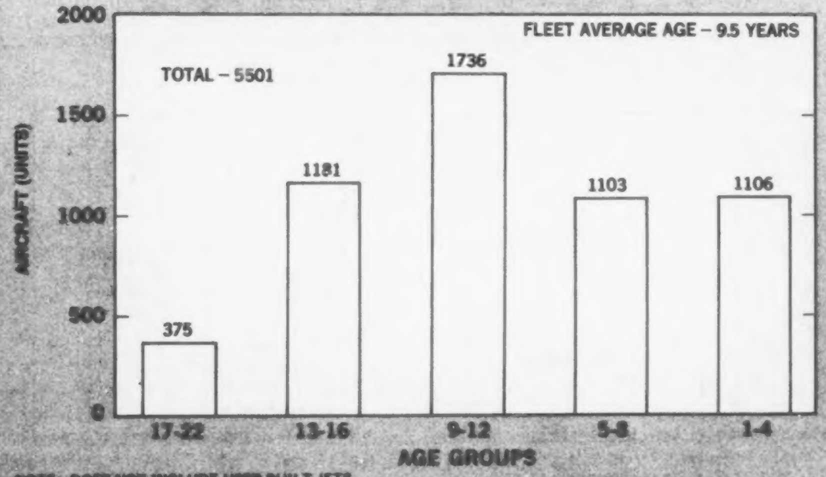
- In Europe, economic growth will be constrained by high wages and less opportunity for outside investment.
- Japan will continue to achieve a high rate of growth through its remarkable cooperation between government, labor and business.

The Market for Commercial Transports

Today, the airlines of the world are operating over 5,500 commercial jet transports and the world fleet has an average age of over 9 years (Figure 4). Over 1,700 transports are between 9 and 12 years old, and over 6 percent of the total fleet are between 17 and 20 years of age. The variety of aircraft in production is impressive, ranging from the 90-seat, 1000-nautical-mile BAC-111 to the Boeing B-747-200 capable of carrying over 400 passengers for up to 4,600 miles. However, many aircraft in service today are no longer in production (e.g., DC-8, Caravelle, Concorde). Just under half of the 5,500 airplanes now in service are obsolete by the

FIGURE 4

AGE DISTRIBUTION OF THE WORLD AIRLINES' JET FLEET



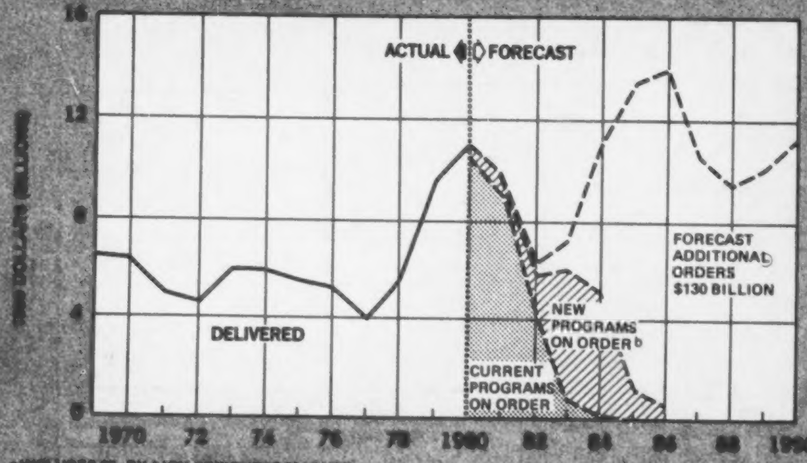
NOTE: DOES NOT INCLUDE USSR-BUILT JETS.
JET AIRCRAFT INVENTORY AS OF DECEMBER 31, 1979

operating standards of the 1980s. Noise constraints, fuel prices and fuel availability, and technological advancements will soon take their toll of today's airline capital equipment inventory.

Each major participant in the aircraft industry periodically assesses the market for both its current and potential products. Although each manufacturer's assessment of the market varies somewhat, the value of the aircraft to be delivered during the 1980s, in 1980 dollars, is expected to be between $110 and $140 billion (Figure 5). This forecast is based primarily on the foregoing economic assumptions. In constant dollars, that represents almost two-thirds of the value of all commercial aircraft sold over the last 30 years. Although the decade is just underway, approximately one-fifth of the airplanes to be delivered in the next 10 years have been ordered; some are just beginning to roll off production lines, reflecting years of design, development, testing, and initial

FIGURE 5

FORECAST OF 1980s COMMERCIAL JET AIRLINER MARKET[a]
ICAO COUNTRIES EXCLUDING USSR AND PEOPLE'S REPUBLIC OF CHINA



[a] INCLUDES $5-BILLION FREIGHTER MARKET
[b] DC-9 SUPER 80, 757, 767, A310

production tooling and material commitments. For the aircraft industry, competition is—and will continue to be—the intense pursuit of a finite number of replacement and growth-related sales opportunities. Again, while the manufacturer's assessments do vary, Figure 6 illustrates current and projected areas of strong jet transport foreign competition.

The jet transport capacity purchased in this decade will first replace existing available seat/ton miles as aircraft become obsolete and, second, will provide for traffic demand growth into the 1960s (Figure 7). Figure 8 shows that, from a demand for 750 billion revenue passenger miles (RPMs) in 1980, growth at only 5.6 to 7.5 percent will yield a market of between 1.1 and 1.4 trillion RPMs in 1990. This expected growth is approximately two-thirds as vigorous as in the decade of the seventies. Air freight demand, estimated at 22 billion revenue ton miles (RTMs) in 1980, could grow to 50 billion RTMs in 1990 (Figure 9).

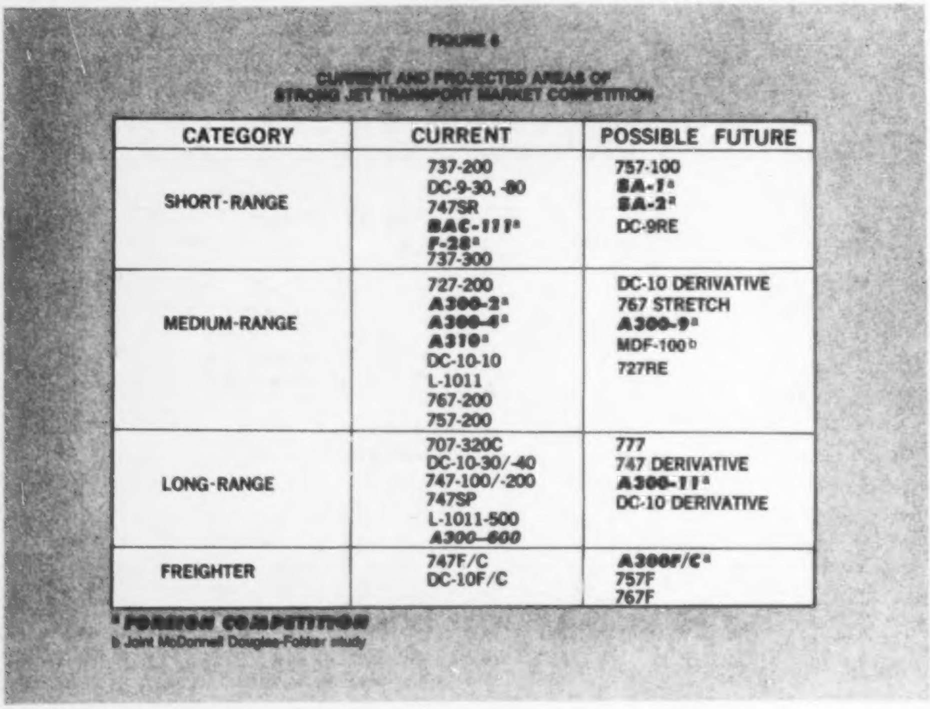


FIGURE 6

CURRENT AND PROJECTED AREAS OF STRONG JET TRANSPORT MARKET COMPETITION

CATEGORY	CURRENT	POSSIBLE FUTURE
SHORT-RANGE	737-200 DC-9-30, -80 747SR **BAC-111**[a] **F-28**[a] 737-300	757-100 **SA-1**[a] **SA-2**[a] DC-9RE
MEDIUM-RANGE	727-200 **A300-2**[a] **A300-4**[a] **A310**[a] DC-10-10 L-1011 767-200 757-200	DC-10 DERIVATIVE 767 STRETCH **A300-9**[a] MDF-100[b] 727RE
LONG-RANGE	707-320C DC-10-30/-40 747-100/-200 747SP L-1011-500 ***A300–600***	777 747 DERIVATIVE **A300-11**[a] DC-10 DERIVATIVE
FREIGHTER	747F/C DC-10F/C	**A300F/C**[a] 757F 767F

[a] ***FOREIGN COMPETITION***

[b] Joint McDonnell Douglas-Fokker study

Foreign Competition in Commercial Transport Production

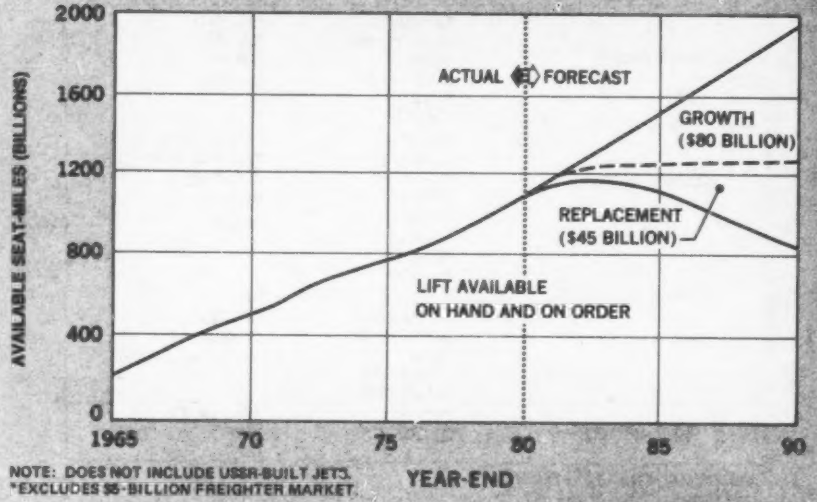
U.S. aircraft and engine manufacturers have dominated the world markets since the introduction of the jet transport, although the first jet transport was made in Europe. During the 15 years before 1979, U.S. aircraft makers captured nearly 90 percent of the market annually. With the emerging success of the European Airbus program, this sort of continued domination is unlikely. For example, in 1979, Airbus received more than 30 percent of wide-body orders placed during the year, a share equal to the combined orders of Lockheed and McDonnell Douglas. See Figure 10 for a summary of trends in the free world commercial jet airliner market.

There are a number of compelling reasons to anticipate the continued growth of non-U.S. jet transport manufacturing and marketing.

First, the market for jet transports is large and is growing rapidly even when inflation is taken into consideration. The

FIGURE 7

WORLD MARKET REQUIREMENTS FOR AIRCRAFT REPLACEMENT AND TRAFFIC GROWTH*
1980–1990



NOTE: DOES NOT INCLUDE USSR-BUILT JETS.
*EXCLUDES $5-BILLION FREIGHTER MARKET.

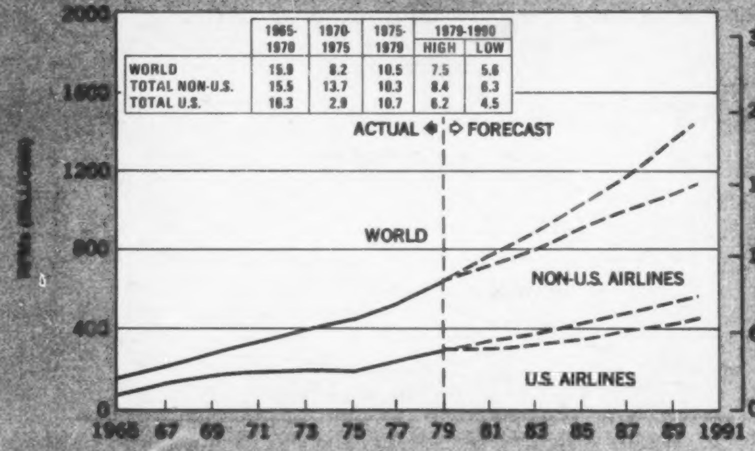
market can be expected to expand in the foreseeable future because there is no strategic competition on the horizon for jet transportation when it comes to moving people and material long distances over varied terrain and climate.

Second, from a technological standpoint, commercial transports are a natural area for expansion for the highly-developed nations. Commercial transport technology is complementary to military aircraft technology and military aircraft capability is already a requirement for many of the developed nations. Then, too, aircraft technology is readily accessible. Since 1940, technological advancements have been freely shared among the academic community and, more recently, between nations and private corporate interests. As indicated earlier, there is a trend as well for the developed nations to move into industries of higher technology as their traditional industries can no longer compete with those of emerging nations.

Third, a commercial transport industry is an excellent

FIGURE 8

WORLD REVENUE PASSENGER-MILES
FOR U.S. AND NON-U.S. AIRLINES
1965–1990



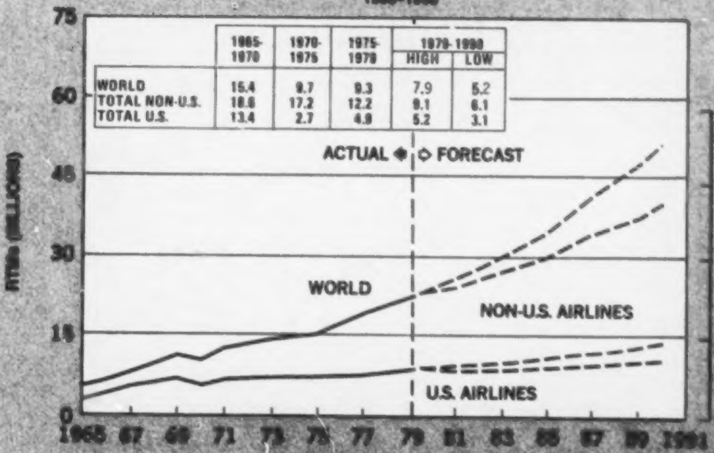
	1965-1970	1970-1975	1975-1979	1979-1990	
				HIGH	LOW
WORLD	15.9	8.2	10.5	7.5	5.6
TOTAL NON-U.S.	15.5	13.7	10.3	8.4	6.3
TOTAL U.S.	16.3	2.9	10.7	6.2	4.5

NOTE: EXCLUDES USSR, PEOPLE'S REPUBLIC OF CHINA, AND NON-ICAO NATIONS, BUT INCLUDES TAIWAN AND ALL-CHARTER CARRIERS means of earning needed foreign exchange. All of the world's industrial nations have suffered merchandise trade deficits in recent years due to a burdensome dependence on imported oil, food supplies and non-fuel minerals. Increasingly, national priorities have become conscious reflections of the need to earn export credits to pay for these economic fundamentals.

Fourth, the largest growth in travel demand is outside the United States (Figures 11a and 11b) and it will become more difficult for U.S. manufacturers to remain dominant in these markets. The United States is the world's largest single market for jet travel and air shipping, as defined by geographical boundaries. Since the early 1970s, however, growth in demand for these services has been greater in other world markets; new carriers have emerged there and new air routes and fare structures have opened. Moreover, national presence in world capitals has become more prestigious and trade has become increasingly significant to the

FIGURE 9

WORLD REVENUE FREIGHT TON-MILES
FOR U.S. AND NON-U.S. AIRLINES
1965–1990



	1965-1970	1970-1975	1975-1979	1979-1990	
				HIGH	LOW
WORLD	15.4	9.7	9.3	7.9	5.2
TOTAL NON-U.S.	18.6	17.2	12.2	9.1	6.1
TOTAL U.S.	13.4	2.7	4.9	5.2	3.1

NOTE: EXCLUDES USSR, PEOPLE'S REPUBLIC OF CHINA, AND NON-ICAO NATIONS, BUT INCLUDES TAIWAN AND ALL-CHARTER CARRIERS preservation of a strong national economy. Every reputable forecasting authority, both within and outside the aircraft industry, expects this trend to continue during the next decade. By the end of the decade, non-U.S. air travel will represent two-thirds of the world's travel market. It is only logical to expect that nations with strong international trade expertise will want to increase their share of that market.

Finally, an immeasurable but real bonus attached to the building of commercial transports is the benefit of prestige, of showing the flag, or gaining international preeminence. The supersonic Concorde, while economically a less-than-desirable product, has still afforded benefits to both France and the United Kingdom. The massive national subsidization of the Concorde program is sufficient witness to the real or imagined benefits derived by those nations. A successful commercial transport program, with commercial transports operating throughout the world, offers a significant measure of prestige and influence to any nation.

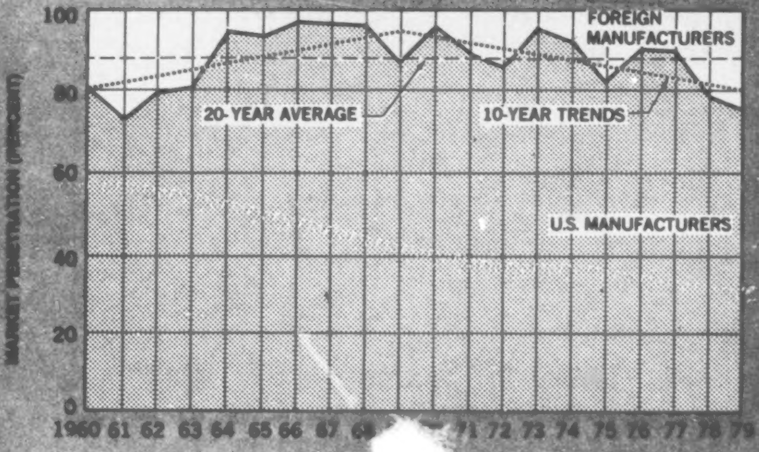
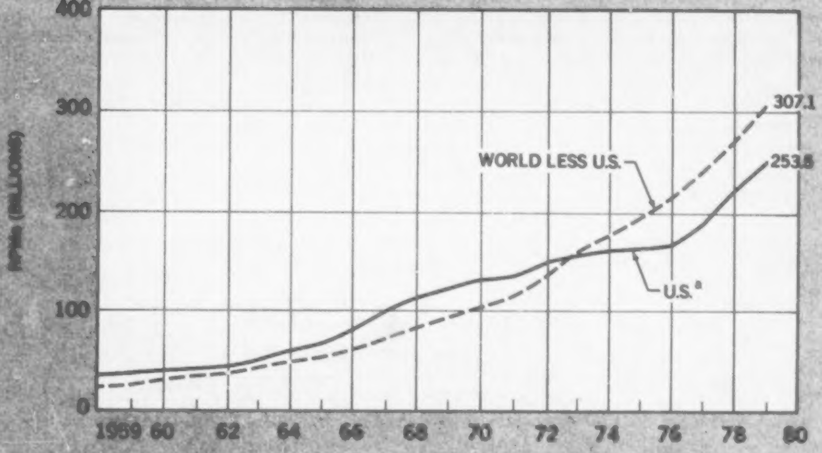


FIGURE 10

FREE WORLD COMMERCIAL JET AIRLINERS
COMPETITIVE MARKET PENETRATION SUMMARY
1960–1979
(Booked-Dollar Basis)

FIGURE 11a

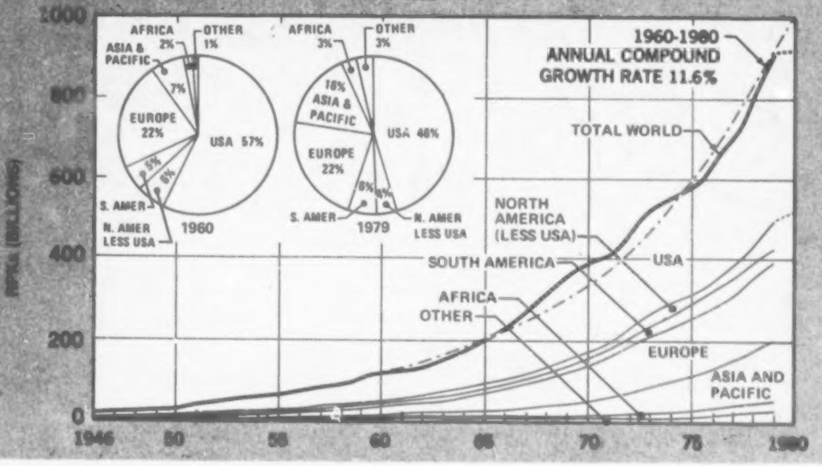
SCHEDULED U.S. AND NON-U.S.
REVENUE PASSENGER-MILE TRAFFIC GROWTH
1959–1980



ª INCLUDES DOMESTIC TRUNK, INTERNATIONAL TRUNK, AND LOCAL SERVICE AIRLINES

FIGURE 11b

AVERAGE ANNUAL GROWTH IN SCHEDULED PASSENGER KILOMETERS
FOR WORLD AIRLINES BY REGION
1946–1980



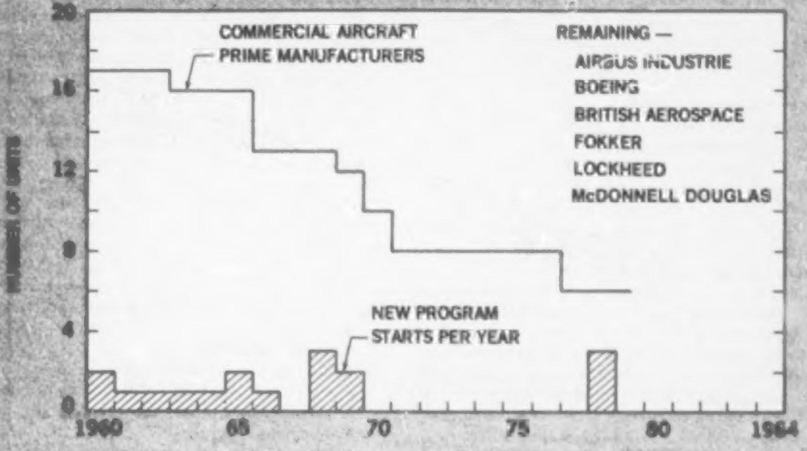
THE RISKS INVOLVED IN CIVIL AIRCRAFT PRODUCTION AND MARKETING

The risks of committing to production of a modern jet transport for commercial markets are increasing. The usual risks facing the U.S. civil aircraft industry include funding, future earnings, reputation, customer acceptance and design obsolescence, but these risks are characteristic of those accepted by any capital goods manufacturer. The significant difference is in the magnitude of the undertaking. Billions of dollars in pre-production commitments are common in the design, subcontracting, tooling, marketing and certification stages of production of today's jet aircraft models. Most of these costs are not recoverable for many years, not until hundreds of units of the product have been produced and sold. And few civil jet transports have sold in sufficient numbers in the dynamic markets of the last 25 years to have earned a profit for their makers or for the governments that sponsored them. A look at industry participation is itself illustrative. In 1960, there were 17 prime manufacturers of commercial transport aircraft in the free world; today, there are only six—Airbus Industrie, Boeing, British Aerospace, Fokker, Lockheed and McDonnell Douglas (Figure 12). In the last 20 years there were fewer new program starts than in the 10 years between 1950 and 1960.

The billions of dollars involved in program launch costs are only part of the risks assumed by aircraft manufacturers.

FIGURE 12

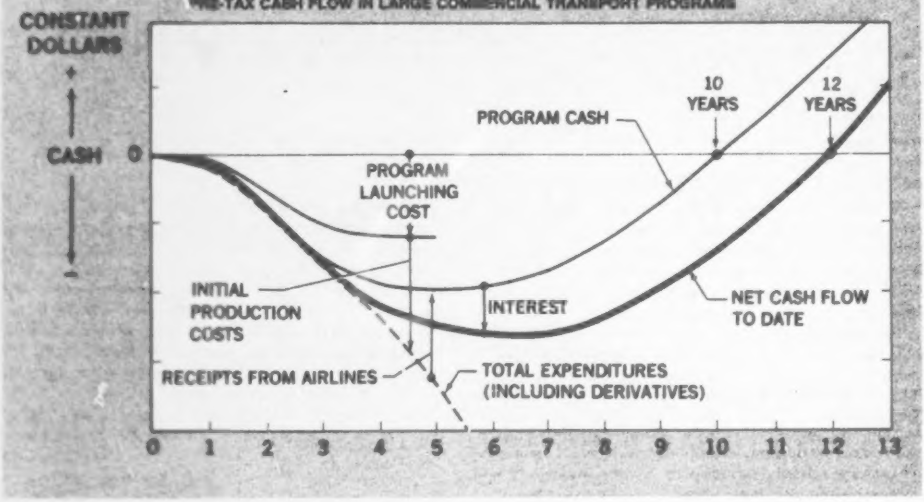
COMPETITION IN THE FREE WORLD COMMERCIAL TRANSPORT INDUSTRY*
1960–1980



*EXCLUDES DERIVATIVE AIRLINERS, COMMUTER AND EXECUTIVE AIRCRAFT

FIGURE 13

PRE-TAX CASH FLOW IN LARGE COMMERCIAL TRANSPORT PROGRAMS



Getting aircraft into the market-place as quickly as possible to achieve competitive advantage and initial cost recovery requires the commitment of large sums of capital to meet high initial rates of production. Equity capital is rarely available in sufficient amounts and large debt burdens are therefore assumed. Debt service costs mount quickly, heightening the cash flow crisis if initial sales are slow. Since the typical, competitive pricing scheme amortizes development costs over many units of production, the airframe and engine manufacturers and hundreds of suppliers become committed to an aircraft's success many years before breakeven—and profitability—are achievable. Moreover, since the introduction of jet transports in the late sixties, derivative versions of each aircraft model have been necessary to maintain a sales pace. With each derivative comes added development costs, extending the cash flow deficit over still more years and units of production.

One of the keys to continued presence in the marketplace—given a market for an aircraft model and its derivatives— is productivity. Each aircraft produced provides a learning experience for management, suppliers, and employees. This "learning curve" phenomenon results in a cash flow drain per unit until the out-of-pocket cost to produce is equal to, or less than, the selling price. With the positive cash flow which follows, eventually—with sufficient unit sales—breakeven and profitability can be achieved. Given the extreme competitiveness of the commercial transport business, it is not unusual to have to deliver 400 units of the initial model before breakeven is achieved. Each derivative thereof requires a further increase in unit sales to achieve breakeven.

The magnitude of the initial investment, which must be maintained over long periods and through economic cycles, varies widely and depends upon an array of factors. Principal among these are the size of the aircraft, initial sales acceptance and production rates, timing and extent of product improvements, inflation, individual program productivity, extent of risk assumed by suppliers, debt versus equity funding used, purchase payment provisions, and delivery uncertainties. Figure 13 shows how long term a venture the initiation of an aircraft program can be. Since jet transport technology was introduced into commercial service, the ratio of program launching costs-to-equity for the manufacturers has always exceeded 1.3 to 1.0.

Factors which create uncertainty in new aircraft introduction and significantly affect the return on initial commitment include:

- World market size
- Geographical distribution of the market
- Number of the product offered in the segment of the market for which the model is designed
- Competitive pricing
- Post-certification engineering costs (i.e., inservice problem solving)

- Performance of the product to a wide variety of customer requirements
- Continued new customer acceptance
- Follow-on sales
- Cost control under cyclical economic conditions
- World economic environment
- Timing of introduction of new models and derivatives
- Government involvement

Through 1980,a total of 20 commercial jet transport programs have been launched and over 7,000 aircraft manufactured and delivered (Table 4). Only ten of the 20 aircraft models are still in production and only a few are widely accepted as having achieved profitability. The common denominators among the successful ventures were (a) large-scale acceptance by a worldwide market early in the life of the program, and (b) initial production efficiencies, coupled with (c) substantial advances in computer-controlled manufacturing during the last decade.

Billions of dollars, then, are required to launch an airplane program in the eighties, and many years of continued design improvement or derivative development must pass before development costs are recovered. Why does it take so long to recover these costs? The reasons are many but, in summary, they include: the magnitude of the initial design investment, heavy initial production commitments, the size of the market and time-related demands of the airlines, technological advancements which create opportunities for derivative aircraft models, costs related to operating improvements, pricing imperatives, inflation, and unpredictable economic cycles. Manufacturers must be continually attuned to the air carrier industry which is struggling to produce a contemporary return on investment that will in turn generate sufficient capital to replace obsolete aircraft and to fund growth. If production volumes are too small, due in part to an excessive number of models being offered, this will not be possible.

The principal benefactors of aircraft programs continue to be the traveling and shipping public; the employees of the manufacturers, the airlines, and supplier industries; and the national economy. Aircraft industry profitability is less than the average profit for all U.S. corporations.

Financing Aircraft Production and Marketing

Historically, over 80 percent of the world's commercial jet aircraft have been manufactured in the United States and marketed in an essentially free enterprise manner. While it is true that the number of competitors in the market has declined, it is also true that for many of the rising competitors some of the fundamental uncertainty of the enterprise has been reduced by government support.

The U.S. free enterprise system is financed in large measure by the flow of private capital to commercial ventures which have the potential to protect and multiply that capital. The alternatives to be weighed in determining the amount of capital which flows into a particular venture have increased in recent years. In addition, the factors of the marketplace have been distorted by inflation. Not only has the amount of risk capital required to launch an aircraft program become larger, but the cost rate of that investment has increased as well. Since a substantial portion of recent aircraft programs has been based on debt capital, as the debt burden grows larger the size of each program—in terms of units of production required to cover these costs—must be greater or unit cost could become prohibitive. The risks become increasingly greater as well.

In Europe, Airbus Industrie, Fokker and British Aerospace receive support in facing these risks from their respective national treasuries. This assistance is in response to European Economic Community policies of economic cooperation and regional security, as well as in accordance with national priorities (e.g. trade balance and employment), and a spirit of pride and independence.

Because of the fundamental differences between the U.S. economic system and the economic systems of its competitors, the means available to minimize the risks of an aircraft program undertaking are significantly different.

TABLE 4

COMMERCIAL JET AIRPLANE DELIVERIES THROUGH 1980

U.S. Manufacturers		
707/720		939
727		1,692
737		715
747		487
DC–8[a]		556
DC–9		955
DC–10		339
L–1011		195
880[a]		65
990[a]		37
	Sub-Total	5,980
Non-U.S. Manufacturers		
Comet[a]		112
Caravelle[a]		279
Trident[a]		117
VC–10[a]		54
BAC–111		227
F–28		158
Mercure[a]		10
A–300		121
VFW–614[a]		10
Concorde[a,b]		12
	Sub-Total	1,100
	Total	7,080

a No longer in production

b 15 Aircraft were produced but only 9 were delivered

Capital Risks

The fears and fortunes of commercial aviation operators spring from the cyclical nature of individual national economies and the world economy. Because airlines have a propensity to commit their future earnings to equipment purchases at times when earnings are rising, there is a consequent effect on airframe manufacturers.

The relationship between earnings and orders for the U.S. airline industry is illustrated in Figure 14, and the high correlation between reported earnings and orders for future aircraft deliveries is evident. This demonstrates why it is so important that aircraft manufacturers introduce the right aircraft (range, capacity, technology, and performance) at the right time (business cycle, market demand, operating environment, fleet age, and so on). Timing is one of the largest risks facing manufacturers and requires early commitment of capital and a substantial cash flow to meet the demands of the uncertain business cycle over different programs and demand levels.

The constant dollar debt compiled by the three U.S. airframe manufacturers between 1965 and 1979 (Figure 15a) will illustrate the substantial debt financing undertaken in a typical aircraft manufacturing program. Some industry history further clarifies the capital risk involved. In 1965, four U.S. firms were developing and manufacturing commercial jet transports. In the years following, Convair (General Dynamics) dropped out of the market after substantial losses; Douglas Aircraft found it necessary to merge with McDonnell Aircraft after running into financial difficulty; Lockheed required a government guaranteed loan; and Boeing, at one point, carried over a billion dollars in debt. Today, in fact, Boeing's commitment to both the B-757 and B-767 programs represents multibillions of dollars in private equity and debt capital. Despite the size of the financial commitments to aircraft programs, profitability is far from assured. As we have seen, few aircraft programs to date could be said to have been profitable. Only time will tell how many of the other nine aircraft currently in production will reward their manufacturers for their investment.

While the U.S. industry was in difficulty during the early seventies, production was cut back and thousands of U.S. workers were laid off to hold down costs and reduce future risks. The employment levels of the 1966–68 period, in fact, have not been repeated in the U.S. aircraft industry. But a look at Europe's experience with the Concorde program will point up an important difference in the risk environment for private versus nationalized manufacturing enterprises.

FIGURE 14

AIRLINE NET EARNINGS VERSUS ORDERS
FOR NEW TRUNK CARRIER AIRCRAFT
1958–1980
(Millions of Current Dollars)

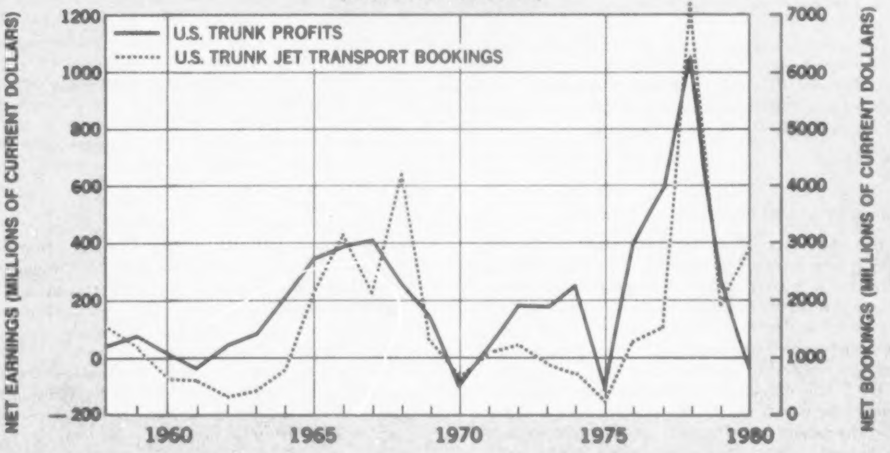
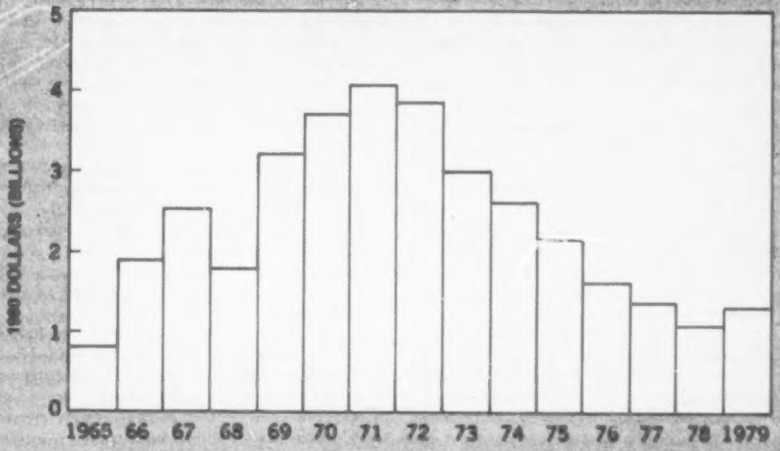


FIGURE 15a

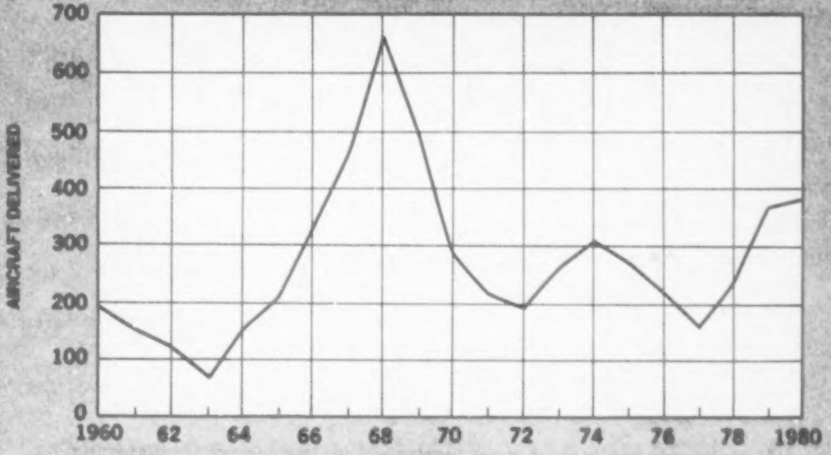
TOTAL DEBT OF U.S. COMMERCIAL AIRCRAFT MANUFACTURERS
1965–19
(Billions of Dollars)



SOURCE: COMPILED FROM ANNUAL REPORTS OF BOEING, DOUGLAS, AND LOCKHEED, 1965-1979.

FIGURE 15b

U.S. MANUFACTURERS' COMMERCIAL JET DELIVERIES[a]
1960–1980



[a] INCLUDES 707, 720, 727, 737, 747, CV880, CV990, DC-8, DC-9, DC-10, and L-1011 (U.S. GOVERNMENT PURCHASES EXCLUDED)

When Europe's Aerospatiale terminated production of the Concorde Supersonic after selling only nine of 16 aircraft produced, the impact on the involved economies was quite different from that experienced in the United States during its aircraft industry difficulties. The French and British governments absorbed the Concorde losses and went on to participate in financing the Airbus consortium in 1971.

An understanding of the nature of aircraft production programs will help illuminate the cash flow problems and capital risk. Aircraft programs are characterized by high production rates during the first few years, generally followed by a drop in production as the airplanes are assimilated into the airline systems. Then, depending upon the economic/business cycle, production will later rise again as demand grows and sales are stimulated by model derivatives. Figure 15 demonstrates this characteristic of aircraft production programs over time with a look at the pattern of U.S. commercial jet deliveries. An important consideration for manufacturers is that multiple programs in various stages of production and demand help maintain more nearly constant total manpower requirements.

The pricing structure of the aircraft industry—as it relates to the high unit production costs of the first several hundred of an aircraft intensifies capital risk. Profitability generally requires improvement through time as the total number of units delivered increases and the initially higher per unit costs encountered at the beginning of the learning curve are reduced. Typically, however, airplanes are priced far below initial unit costs to facilitate market introduction. It does require a large market and continual engineering and operating improvements to sustain market interest, and capital funding to accomplish this adds further to the cash flow commitment necessary to remain in production. The larger the market, the more units over which this cost recovery can be spread and the lower the unit price for all customers, foreign and domestic (Figure 16). This points up one of the important benefits of aircraft sales abroad. A recent industry analysis found, for example, that the price per unit to U.S. airlines *without* export sales markets, would be 40 percent greater.

The peak investment for a commercial jet program can easily reach several billion dollars and may not be recovered for 10 to 15 years and then only if the program is successful. Recovery time for the basic program is often extended as additional investments are required for derivatives for product improvements to meet market requirements. Successful programs, then, must have long production runs spanning these long capital recovery periods.

The fundamental difference between the European/Asian and U.S. economic systems is clearly reflected in the sources of capital to finance these long-term recovery commercial jet transport programs. In the United States, manufacturers must rely upon retained earnings, equity investments and debt financing for capital investment—in a private enter-

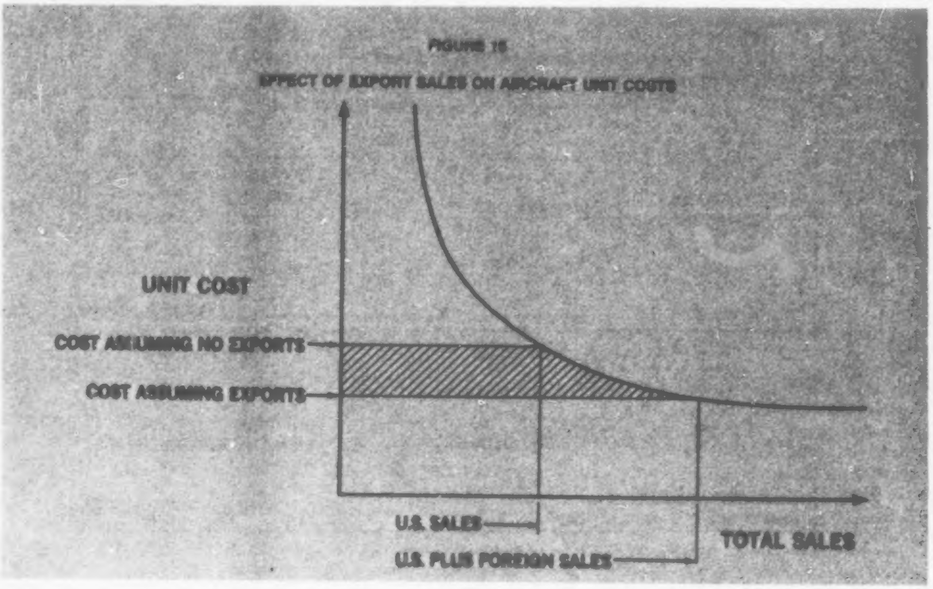


FIGURE 16

EFFECT OF EXPORT SALES ON AIRCRAFT UNIT COSTS prise environment characterized by open competition among alternative investment opportunities. Moreover, because of inflation, investment funds have been fewer and, when available, quite costly. European aircraft manufacturers function in a different environment where, in contrast, the national treasuries of the European Economic Community provide a large portion of the capital. The criterion for capital availability is not return on investment as it is in a private, market economy, nor is the cost of the capital always a function of the business/economic cycle. Rather, it is a matter of national policy to fund the development and perpetuation of a high-technology aircraft and aerospace industry.

Market Risks

Today, a new aircraft program must maintain its viability in the marketplace for 15 to 20 years. Because of the complexities of the market and changing technology, the initial choices of product characteristics and the time of launch are the biggest risks involved. The strength of these decisions will have to support the capital risks already described.

Four major factors influence the design of commercial jet transports: (1) economic efficiency, (2) validated technology, (3) airline marketplace, (4) airframe/engine compatibility and competition, and (5) regulatory requirements (e.g., with respect to environmental conditions). The successful product program must be responsive to the ever-changing dimension of these and other factors. No airplane program continues very long with the same product characteristics initially selected. Figure 17 illustrates important ways in which the initial design can be modified to meet changing airline requirements and improve its marketability over extended periods of time. Alternative gross weights, fuel capacities, cargo and passenger configurations, engine choices and operating standards, for example, are typical modifications to the payload/range design for the marketplace.

The selection of the "Basic Design Point" of a commercial jet program can take years of research, consultation with airlines and reviews of changing external forces (such as fuel price and availability, environmental constraints, financing). It involves engineering development and engine competition and requires millions of dollars for related research and development. Figure 18 presents the range of choices for basic design points up to this time. Only major derivatives to commercial jet programs are shown.

Before a Basic Design Point is chosen, the following factors must be identified:

- Worldwide airline service market
- Expected growth in demand (new and existing markets)
- Stage-length evolution
- Marketing practices and airline service objectives
- Investment costs per seat

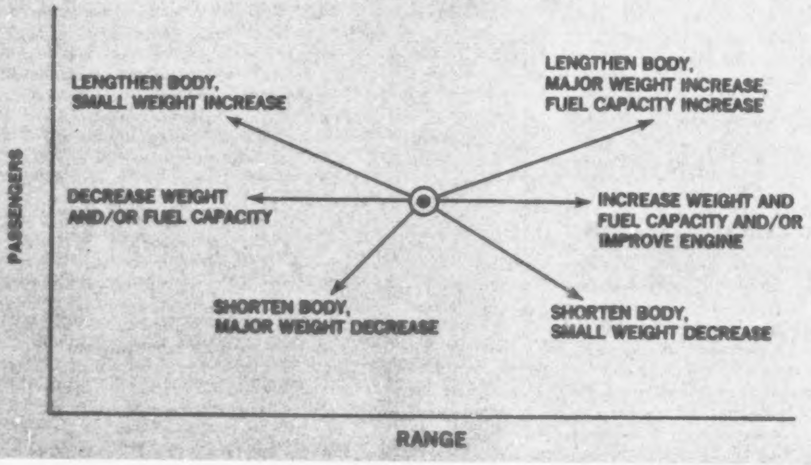
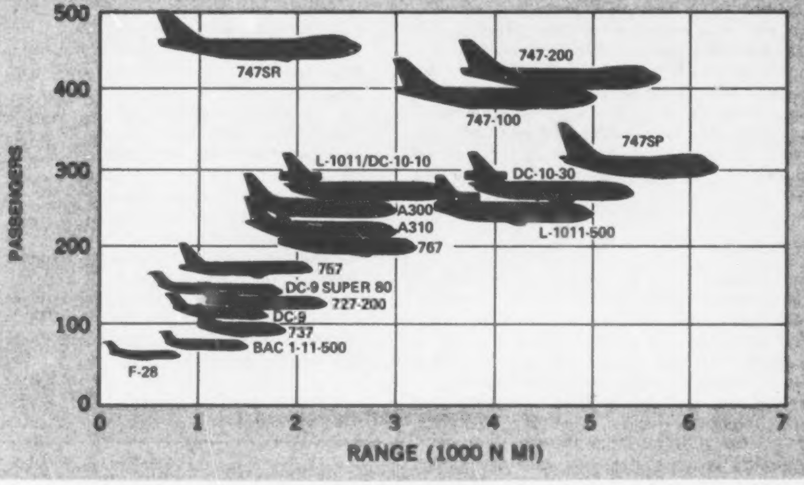


FIGURE 17

POSSIBLE DESIGN MODIFICATIONS TO MEET CHANGING AIRLINE REQUIREMENTS

FIGURE 18

RANGE OF CHOICES FOR BASIC AIRCRAFT DESIGN POINTS



- Operating costs (per seat mile, per airplane mile)
- Available propulsion technology
- Operating performance (takeoff/landing)
- Compatibility with existing fleets
- Existing fleet age and condition
- Existing fleet reassignment possibilities
- Potential for profitability
- Emerging and/or validated materials and sub-system technology

Ultimately, the Basic Design Point is a carefully weighted compromise of rapidly emerging needs with emerging technology, and the least-cost opportunity available for initial and potential derivative models. A billion or so dollars must then be available to finance the venture in a manner that will not adversely affect the price offering, nor inhibit the necessary initial production rate. In recent years, the availability or capacity of the materials supply network to meet production rate demand has also become increasingly crucial as airframe manufacturers typically subcontract one-half the total manufacturing activity to industry suppliers.

The larger the marketplace, the more likely a program is to be successful. Any perturbations which diminish the size of the program or extend the time over which a model is actively in demand endanger its viability. Naturally, the wider the product line the greater the market for a particular manufacturer and the more flexibility available to meet planned and unplanned demand changes. The loss of any opportunity to compete in the market automatically increases the risk of the total program.

Initial sales of particular jet transport equipment to each single customer are critical. The outcome of the initial sales competition for a market model will have long-term effects upon the total industry. Because of compelling reasons—primarily the commonality of equipment, which helps hold down maintenance and crew costs and reduces scheduling problems—the loss of an initial sales opportunity to an airline will likely result in the loss of that carrier's market —for that size aircraft—for 15 to 20 years. Moreover, follow-on and spare parts sales always exceed the value of the initial order. Table 5 illustrates the cumulative effect from initial sales of several Boeing aircraft since 1959. In terms of both numbers of units sold and value, follow-on sales are nearly three times—or more—voluminous over the life of a program as that first order. The average follow-on export sale for Boeing, Douglas, and Lockheed aircraft between 1971–77 was three times greater than the initial export sale.

Initial sales success or failure with a particular airline in a region can influence the decisions of other carriers in that entire market. There is a demonstrated "domino effect" from initial carrier decisions. Because airlines within common regions can take advantage of the favorable economics associated with joint maintenance support and spares pooling agreements, the initial penetration of an airplane type results in most, if not all, airlines in that region acquiring the same airplane. A recent example is Airbus penetration of the Silk Route market which encompasses the Pacific Rim, Asian subcontinent, and Arabian Gulf. These regions are rich in manpower and resources and have experienced rapid growth in GNP, trade, and air travel. The demand for commercial aircraft is increasing just as rapidly. The A300 team, including government representatives, has been working very effectively to tie together this regional airline market with the A300 (see Figure 19). As shown, A300 sales efforts were successful in only two countries (eight jets) through 1976, but the team's successes currently include 15 countries (105 jets). Major sales efforts in other nations are underway.

In economies in which major exporting industries are nationalized, such instances of the use of government clout have become increasingly prevalent—not only in aircraft trade but in non-aircraft-related trade as well. The 1979 General Agreement on Tariffs and Trade (GATT) addressed some of the problems and contained a separate code for trade in civil aircraft. While it was signed initially by only 14 countries, the signatories include all the major producers. The Aircraft Agreement has served to point the way to correcting certain inequities which have emerged in recent years. As a result, future purchase decisions should be premised more on performance, quality, price and service.

Political Risks

Political risks are closely identified with differences in national priorities. As mentioned earlier, the European and Japanese national priorities include financial support to industries designated as important to the future of the country. The U.S. government also supports industries of significant importance but in a crisis intervention manner. The foreign governments provide their support in the planning, development, initial production and market testing phases. The financial terms of this support are significantly different as

TABLE 5

CUMULATIVE EFFECT FROM INITIAL SALES OF U.S. AIRCRAFT SINCE 1959
(Number of Aircraft and Millions of Dollars)

	1959–1963	1964–1968	1969–1973	1974–1978	Totals			
					Units		Value	
					Initial	Follow-On	Initial	Follow-On
Air Canada								
DC–8	6[a] + 9	14	13	—	6	36	$ 33.4	$ 300.8
DC–9	—	6 + 31	11	2	6	44	18.8	174.7
B–727	—	—	—	5 + 9	5	9	39.0	74.7
B–747	—	—	3 + 1	2	3	3	67.2	84.3
L–1011	—	—	6 + 0	4 + 0	10	0	190.0	0
SwissAir								
DC–8	2 + 2	4	3	—	2	9	11.0	69.7
DC–9	—	10 + 8	7	10	10	25	35.6	141.2
DC–10	—	—	3 + 0	3 + 2	6	3	127.8	76.0
Lufthansa								
707	4 + 3	13	3	—	4	19	20.6	132.2
727	—	12 + 15	8	26	12	49	50.2	351.9
747	—	—	3 + 5	10	3	15	55.7	563.0
DC–10	—	—	1 + 0	3 + 7	4	7	81.9	161.7
Japan Air Lines								
DC–8	4 + 7	16	18	—	4	37	22.5	314.2
727	—	6 + 5	1	—	6	6	26.4	27.6
747	—	—	3 + 13	21	3	34	55.8	554.2
DC–10	—	—	—	6 + 1	6	1	176.4	36.2
British Airways								
707	15 + 4	5	5	—	15	4	77.6	105.9
747	—	—	6 + 9	10	6	9	111.9	498.5
L–1011	—	—	6 + 3	8	6	3	118.2	289.8
Air France								
707	10 + 15	12	1	—	10	28	51.5	176.2
727	—	4	13	—	4	13	20.3	75.0
747	—	—	4 + 7	11	4	18	73.7	446.9
					135	380	$1,465.5	$4,654.7
					26%	74%	24%	76%

[a] Underline denotes number of aircraft in initial sale

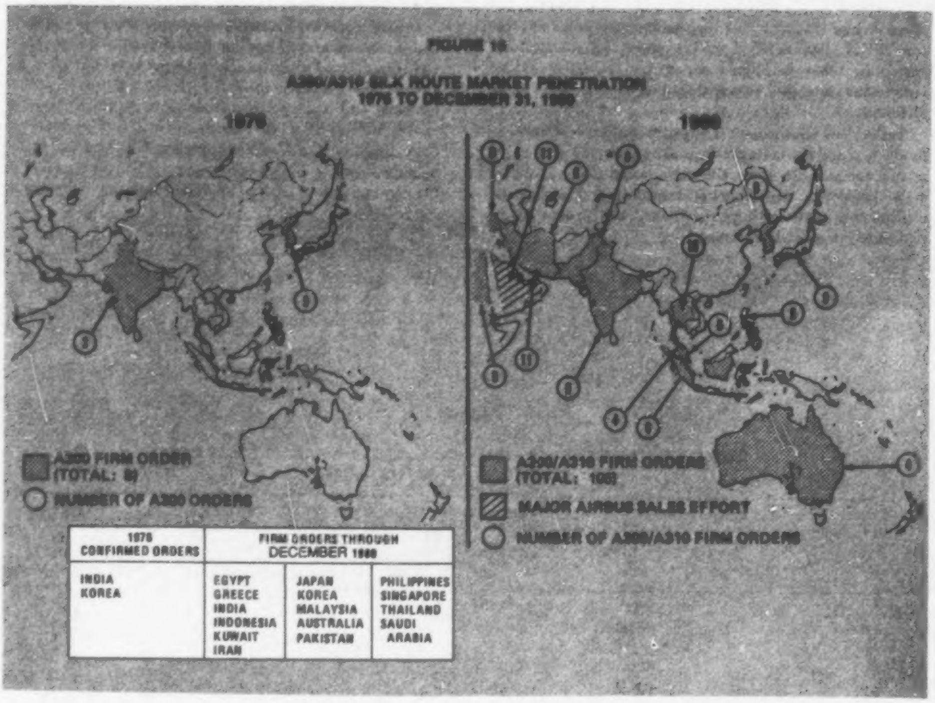


FIGURE 16

A300/A310 SILK ROUTE MARKET PENETRATION
1976 TO DECEMBER 31, 1980

1976
1980
A300 FIRM ORDER (TOTAL: 8)
NUMBER OF A300 ORDERS
A300/A310 FIRM ORDERS (TOTAL: 108)
MAJOR AIRBUS SALES EFFORT
NUMBER OF A300/A310 FIRM ORDERS

1976 CONFIRMED ORDERS	FIRM ORDERS THROUGH DECEMBER 1980		
INDIA KOREA	EGYPT GREECE INDIA INDONESIA KUWAIT IRAN	JAPAN KOREA MALAYSIA AUSTRALIA PAKISTAN	PHILIPPINES SINGAPORE THAILAND SAUDI ARABIA

well. Many countries continue their support as the commitment grows and the economy becomes increasingly dependent on the industry for employment. In contrast with the business-government adversary relationship in the United States, foreign governments and foreign commercial enterprises tend to be more cooperative.

In the United States, trade restraints to promote foreign policy objectives are increasingly common but these objectives are often not supported by the other developed nations of the world. Such foreign policy restraints have become burdensome to the U.S. aircraft manufacturers. In 1979 and 1980, for example, export licenses for almost half a billion dollars in exports were denied one U.S. manufacturer. No comparable restraints are placed upon the Airbus consortium.

While financing terms have become a pivotal item in sales to non-U.S. air carriers in recent years, domestic inflation has placed U.S. financial institutions at a disadvantage in offering competitive terms. Bilateral negotiations to minimize the differences in export financing terms have met with failure. Limitations on private U.S. banking institutions and funding constraints placed on the U.S. Export-Import Bank are denying U.S. exporters competitive equality, given the national treasury support from the European Economic Community.

The difference in approach toward exports between the governments of other nations and that of the United States has increased the risk for U.S. commercial aircraft manufacturers. They must finance massive aircraft program investments in a free enterprise manner while the nations of the European Economic Community, for example, are concerned less with return on investment from a company point of view than on overall national return such as employment, and perpetuation of a high-technology aircraft and aerospace industry. Foreign aircraft are priced to be competitive, as are U.S.-made commercial transports. However, the demands for cost recovery are fewer from national governments than from private financial institutions which face more immediate constraints as a result of inflation and concerns over monetary stability.

The erosion of the U.S. share of world trade continues. Fears that this trend is the result of the transfer of technology to foreign manufacturers by U.S. firms has prompted political constraint of certain high-technology exports. While it is true that high-technology items are the core of U.S. manufactured goods exports, technological advances by other developed nations can be attributed to indigenous capability which does not depend upon U.S. technology.

The Airbus consortium is a prime example of the co-production and marketing of a mutually endorsed venture by several nations. Moreover, the state-owned airlines cooperate in the development of new jet transports and, as they are controlled by participating governments, can be more easily persuaded to provide a demand.

During the GATT negotiations some haunting political issues were addressed and the final civil aircraft agreement was a major step forward in achieving market competition for aircraft sales. At this point, enforcement of the agreement is essential, and as competition grows more intense the need to insure fulfillment of the agreement will also increase. To date, however, the United States has fallen behind other nations in preparing for enforcement. (For information on the General Agreement on Tariffs and Trade and the Aircraft Agreement, see p. 47.)

BUSINESS-GOVERNMENT FRAMEWORK: ITS EFFECT ON INTERNATIONAL TRADE

The success, or failure, of a nation's commercial jet transport industry is inextricably linked to that country's domestic and foreign policies. The nature and extent of this relationship, and the fruits of government-industry interaction, will vary according to these policies. The relative importance of the product or service supply capability of the industry, both nationally and internationally, is central to the relationship. National and international security agreements further influence and complicate a situation of potentially conflicting strategic objectives, for the government-industry relationship is rooted in the technological capability of the aircraft industry and its inevitable position in national defense. As air power is essential to national security, the greater the commercial success of the industry, the more defense capability the nation can support at a given price to the taxpaying public. Despite the inevitability of a close government-industry relationship, there are nonetheless substantial differences between the United States and other countries in their approach to that relationship, where certain domestic and international policy objectives are concerned. These differences form the context for much of this chapter's attention.

U.S. International Trade—The Aircraft Industry's Important Role

In mid-1975, the U.S. balance of all merchandise trade began a 33-month decline. From an annual surplus of well over $9 billion, the U.S. trade balance dropped to a $31.8 billion annual deficit in 1978. Since then, quarterly deficits have stabilized around an average of $7.5 to $8 billion. The rapidly escalating price of imported oil and an economy plagued by inflation are most often charged as root-causes for this turn of events. At the same time, income from overseas investments has made substantial gains and there have been some net gains in the balance of services income. The expectation for 1981 is a surplus of $6 billion in the "current account"—the sum of net balances from merchandise and investment income, military travel, and transportation receipts, along with other services. In 1981, exports and imports grew at approximately the same rate over 1970—30 percent. The rising exchange rate value given to the deutsche mark, yen and franc—prior to the dollar's rise in 1981—has helped make U.S. products more competitive in world markets. Figure 20 and Tables 6 and 7 provide a perspective on the U.S. trade patterns of the seventies vis-a-vis the current accounts of other nations.

Although the U.S. share of the world's exports has declined, volume growth in exports, up 79 percent between 1970 and 1979, has been good. This growth was higher than the 75 percent increase experienced by seven other major industrial countries during the same period. Those seven countries, in aggregate, also experienced a comparable decline in share of world export trade. The reasons are the same for all: higher priced petroleum exports by OPEC countries and very strong growth in exports by some of the developing countries. In 1979, the United States enjoyed a trade surplus of $9.3 billion with the European Economic Community, of $3.4 billion with the other developed countries of the world, of $0.8 billion with non-OPEC developing countries, and of $4.9 billion with communist nations.

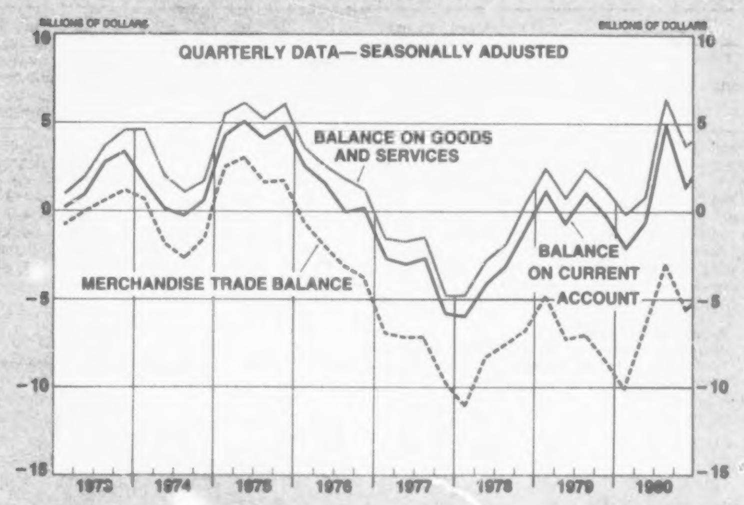
In 1980, exports of manufactured goods accounted for 65 percent of total U.S. exports and generated a surplus of $1.6 billion. The largest single manufacturing industry contributing to this surplus was the U.S. commercial jet transport sector. Boeing, Lockheed, and McDonnell Douglas combined exported $6.7 billion of U.S.-manufactured jet aircraft. Exports of engines, avionics, spare parts and services from within the industry, plus used aircraft and a wide array of accessories, brought that total to $10 billion. After deducting $900 million in imports, the net trade surplus was $9.1 billion. The Boeing Company was identified by ***Fortune*** magazine as the nation's number one exporter (almost $4 billion).

It should be noted, however, that in the midst of the U.S. industry's excellent 1979 performance, Europe's Airbus Industrie captured what was, at that point, its largest share of world jet transport orders for future delivery—31 percent. In 1980, Airbus achieved 32 percent of wide-body orders and, as of September 30, 1981, held 43 percent of the world wide-body backlog.

The commercial jet transport is one of a waning number of examples of U.S. technological leadership. Suffice it to say, the industry makes a substantial positive difference for the United States in world trade. The industry's net export surpluses in both 1979 and 1980 were sufficient to pay for one

FIGURE 20

U.S. INTERNATIONAL TRANSACTIONS
1972–1980



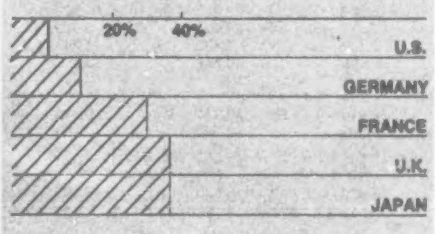
SOURCE: DEPARTMENT OF COMMERCE

day of every week's demand for imported petroleum. Moreover, the industry's products form a solid base for continued exports: follow-on sales, spare parts, accessories and service contracts.

The critical need to export in order to pay for vital imports has led European and Japanese policy makers to recognize the importance of the commercial aircraft as well as other high technology industry sectors. They have acted upon this recognition with financial support for major exporting industries. During 1979, for example, the major industrialized EEC countries and Japan all provided more financial support to exports than did the United States (Figure 21).

FIGURE 21

PERCENTAGE OF TOTAL EXPORTS
BACKED BY GOVERNMENTS
1979



SOURCE: U.S. COMPTROLLER GENERAL

Comparative Government Support of Aircraft Exports

The national promotion of exports, in a variety of forms, has emerged as a significant factor in world market competition. Export credit financing and insurance, tax avoidance or reduction incentives, direct promotion, bilateral agreement negotiations (barter trade), and direct financial assistance are increasingly common. A Business International Corporation study recently compared export incentives and concluded that, among 10 major countries, Brazil provides the most complete package of incentives.[1] The 10 countries in descending order, ranked as follows:

1. Brazil
2. South Korea

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[1] Business International Corporation, Corporate Policy Division, *International Export Incentives: A Comparison and Analysis of Ten Key Countries* (New York, New York, 1979)

TABLE 6

U.S. INTERNATIONAL TRANSACTIONS
1973–1980
(Millions of Dollars)

Period	Merchandise[a,b]			Investment Income[c]			Net Military Transactions	Net Travel and Transportation Receipts	Other Services Net[c]	Balance on Goods and Services[a]	Remittances, Pensions and other Unilateral Transfers	Balance on Current Account[a]
	Exports	Imports	Net Balance	Receipts	Payments	Net						
1973	71,410	−70,499	911	21,808	−9,655	12,153	−2,070	−3,158	3,184	11,021	−3,881	7,140
1974	98,306	−103,649	−5,343	27,587	−12,084	15,503	−1,653		3,986	9,309	−7,186	2,124
1975	107,088	−98,041	9,047	25,351	−12,564	12,787	−746	−2,792	4,598	22,893	−4,613	18,280
1976	114,745	−124,051	−9,306	29,286	−13,311	15,975	559	−2,558	4,711	9,382	−4,998	4,384
1977	120,816	−151,689	−30,873	32,179	−14,217	17,962	1,528	−3,293	5,182	−9,493	−4,617	−14,110
1978	142,054	−175,813	−33,759	43,265	−21,865	21,400	738	−3,178	5,792	−9,008	−5,067	−14,075
1979	184,473	−211,819	−27,346	66,699	−33,236	33,463	−1,947	−2,622	5,460	7,008	−5,593	1,414
1980	223,966	−249,308	−25,342	75,936	−43,174	32,762	−2,515	−798	6,674	10,779	−7,056	3,723

SOURCE: Department of Commerce, Bureau of Economic Analysis.

a Excludes military grants.
b Adjusted from Census data for differences in timing and coverage.
c Fees and royalties from U.S. direct investments abroad or from foreign direct investments in the United States are excluded from investment income and included in other services, net.

TABLE 7

U.S. CURRENT ACCOUNT BALANCES BY AREA AND COUNTRY
1979–1980
(Millions of Dollars)

	1979	1980p	1979–1980 Change
Surpluses			
Western Europe	14,303	20,261	5,958
Eastern Europe	4,300	3,103	1,197
Canada	8,788	7,262	1,526
Latin America & Other Western Hemisphere	7,526	14,451	6,923
Australia, New Zealand and South Africa	2,189	3,432	1,243
Subtotal	37,106	48,509	13,592
Deficits			
Other Countries in Asia and Africa (Includes OPEC)	−24,410	−33,224	−8,814
Japan	−8,583	−8,749	−66
International Organizations and Unallocated	−2,598	−2,814	−216
Subtotal	−35,691	−44,787	−9,096
BALANCE ON CURRENT ACCOUNT	1,414	3,723	2,309

SOURCE: U.S. Department of Commerce, *Survey of Current Business*, June 1981
NOTE: Figures may not add due to rounding

TABLE 8

GOVERNMENT AND PRIVATE SECTOR SUPPORT OF COMMERCIAL JET PROGRAMS IN EUROPE AND THE UNITED STATES

			Europe	U.S.
Government Support	Direct Capital Infusion	R&D Funds	●[a]	○[b]
		Developmental Grants		
		—New Programs	●	○
		—Major Derivatives	●	
		Developmental Loans (Low/No Interest)	●	
		Capital Funds for Facilities/Equipment	●	
		Lease or Use of Government Facilities	●	○
		Infusion of Equity Capital into Government-Owned Companies	●	
		Marketing Support and Subsidies	●	
		Exchange (Currency) Subsidies	●	
	Indirect Financial Support	Technology Transfer From Military to Commercial Aircraft Work	○	○
		Government Guarantees for Bank Loans—New Program	●	○
		Government Guarantees for Bank Loans—Company Rescue	●	●
		Tax Credits	●	●
		Airline Financing of New Aircraft		
		—Domestic (Airlines of Producers Countries)	●	
		—Export	●	●
		Training Funds and Support	●	○
		Government-Aided Marketing	●	○
Private Sector Funding		Earned Venture Capital	○	●
		Bank Loans (Not Government Guaranteed)		
		—Developmental Funds	○	●
		—Inventory Financing	○	●
		Company-Financed Research	○	●
		Company-Backed Airline Financing		●

[a] ● Significant
[b] ○ Minimal

3. France
4. Taiwan
5. United Kingdom
6. Japan
7. Italy
8. United States
9. Canada
10. West Germany

The commercial jet transport industry has become a high priority for export support among the industrialized nations—so much so that, until a recent interim agreement was concluded, a virtual export credit war was underway. The 1976 Organization for Economic Cooperation and Development (OECD) "Standstill Agreement" on terms of export financing had become a casualty of changing economic conditions, and attempts to revise the Agreement in 1980 to reflect current financial market conditions were thwarted, particularly by the French. The role of the European and Japanese governments in their jet transport manufacturing industries helps to explain why concluding a new agreement is so essential. Table 8 illustrates the differences between U.S. and European government involvement in commercial jet programs.

The European commercial aircraft industry is essentially consolidated in Airbus Industrie, a consortium of predominantly government-owned or controlled enterprises consisting of companies from France (37.9 percent), Germany (37.9 percent), the United Kingdom (20 percent), and Spain (4.1 percent) as full partners, with Belgium and The Netherlands as associates. (The French and Spanish companies involved are essentially government-owned, the German and Belgian companies about 50 percent government-owned—as is British Aerospace since its recent denationalization—while Fokker of The Netherlands is a privately-owned company.) Government financial support is provided these companies through a variety of means not available to U.S. firms. As a result, the prices of aircraft for Airbus Industrie programs (A300 and A310) probably do not reflect the full economic costs that would have to be accounted for and recovered under the U.S. private enterprise system.

In addition to providing financial assistance, the governments involved in Airbus Industrie play an active role in the marketing function. Initial sales of the Airbus A300 were extremely slow; only 57 airplanes were ordered during the first seven years, a situation which would probably have forced a U.S. firm to abandon the project. The initial sales were almost certainly directed procurements to "buy national;" French Finance Minister Jean-Pierre Fourcade reportedly put such pressure on Air France in January, 1975. Other sales resulting from government pressure included Lufthansa, Iberia and, more recently, Sabena. Once an aircraft model is established in a fleet, however, there is no further need for such pressure; a carrier then has an economic incentive to buy additional units (and derivative models) because of the previous investment in spares, training, specialized ground support equipment, crew familiarity with the equipment, and so forth.

Political leverage is another important factor in the sale of European-produced aircraft. Events have provided some evidence of a continuing involvement by the governments of Airbus participants to induce aircraft sales by associating them to political agreements such as: (a) trade agreements; (b) route awards/landing rights/frequency rules adjustments (e.g., Korean landing rights in Paris, Iberia frequency agreement in European routes, Swissair traffic rights with France, the United Kingdom, West Germany); and (c) military weapons support (e.g., atomic power plants to Iran, a petrochemical plant and Paris real estate joint venture to Kuwait). An interesting twist in political leverage was Australia's use of the Trans Australian Airline's purchase of A300s as leverage to encourage the European Economic Community to buy more Australian mutton.

Another approach used by government-backed European aircraft producers to induce sales is the provision of special terms that exceed the bounds of normal commercial practice. The Airbus sales to Eastern Airlines for example, included a "Deferred Seat Plan" in which 12 of 23 airplanes will be paid for as if they had only 71 percent of the 240 seats for up to four years, or until load factors exceed a certain level.[1] Although seats will eventually be paid for, the deferral is interest-free. Eastern also had use of four A300s for a six-month trial period without lease cost.

The Japanese Government, through the Ministry of International Trade and Industry (MITI), has stated its intent to promote development of its commercial aircraft industry through international cooperation. Although Japanese aircraft companies are not government-owned, they receive support in new aircraft development programs through government loans. This applies both to Japanese programs and to Japanese participation in international cooperative programs. These loans are repaid with interest if and when the project turns a profit. This has not occurred in Japanese programs to date. Unlike European policy, Japanese government policy excludes funding assistance for production and marketing functions.

The level of Japanese funding assistance typically amounts to 50 percent of the Japanese share of development costs for aircraft programs. In the case of the RJ500 engine, which is a joint program between Japanese companies and Rolls-Royce of the United Kingdom, the government is expected to fund over two-thirds of the Japanese share of the development costs.

Prior to the Agreement on Trade in Civil Aircraft, which went into effect January 1, 1980, directed procurements by the governments of Airbus Industrie participants were practiced, establishing the pattern for follow-on sales by the carriers involved. Signatory governments have now agreed that aircraft prices should be based on a reasonable expectation of recoupment of all costs. While there is no requirement that each particular aircraft program must break even, production and marketing programs should be planned so that, with a reasonable production run, the aircraft program will cover all of its nonrecurring—such as production, finance, and marketing—costs. The total costs involved include the "identifiable and pro-rated" costs of military-funded development of civil aircraft and of components which are subsequently incorporated in civil aircraft. Such a provision is consistent with existing U.S. Government policies on recoupment for government-funded research to the extent it benefits a commercial enterprise.

The agreement also states that signatories shall not require, nor exert unreasonable pressure on, airlines, aircraft manufacturers or other entities engaged in the purchase of civil aircraft, to procure civil aircraft from any particular source. It is nonetheless true that the governments of Airbus Industrie participants still have a wider range of marketing opportunities available to them, due to the close relationship in those countries of political and commercial interests.

In the past, U.S. commercial jet manufacturers, competing solely against one another for an airline order, have only rarely sought or received assistance from U.S. diplomatic personnel abroad. The government's rigid adherence to a position of neutrality with respect to U.S. competitors and the exporters' natural reluctance to disclose their game plans tended to appreciably reduce the value of any such cooperation. Now that sales competition in many instances is not only between individual U.S. manufacturers but between U.S. producers and foreign manufacturers backed and supported by their governments, such assistance and cooperation will undoubtedly be increasingly sought by U.S. exporters. As this happens, it will be essential that the U.S. government give full support to its aircraft exporters, if the United States is to remain the world's foremost supplier of commercial aircraft.

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[1] *Air Transport World*, July 1978, p. 25, and Hearings Before the Subcommittee on Trade, House Ways and Means Committee, July 14, 1978 (Report 95-101).

On a number of occasions, the U.S. Trade Representative has interceded with foreign counterparts in attempts to assure compliance with the Agreement on Trade in Civil Aircraft. The U.S. government provides other, albeit limited, assistance to U.S. jet transport manufacturers, which is discussed later in this chapter.

The Role of Research and Development

U.S. commercial jet transport manufacturers are working exceedingly hard to maintain their competitive position in the world market. They have committed billions to introduce new and improved, fuel-efficient models in several market areas. The McDonnell Douglas DC-9-80 represents a significantly improved aircraft that had its initial airline delivery in 1980. The Lockheed L-1011-500 has become the first civil program to utilize some new advances in control system efficiencies. The Boeing-757 and 767 each represent new multi-billion-dollar programs with initial airline deliveries scheduled for 1982 and 1983. The Pratt and Whitney PW 2037, JT9D-7R4 and the General Electric CF6-80 engines are similar commitments in the aircraft engine business.

The aircraft manufacturers represent a bright spot in U.S. industrial productivity as they have been able to modernize and expand production capabilities. As a result, the U.S. commercial transport aircraft is still a sound competitor in fuel efficiency and price when price reflects real cost.

From a near-term technological perspective as well, the U.S. commercial transport aircraft is still a sound competitor. Nonetheless, the expansion of foreign R&D capabilities—much of it funded by the governments involved—is challenging U.S. leadership. In some cases, foreign developments are outpacing U.S. programs. Because of this challenge to its technological leadership, the U.S. industry's competitiveness has become much more sensitive to export financing and other aspects of government policy.

Foreign near-term market successes and increasing production are combining with their building block research in a surge that seriously threatens the U.S. industry's future. The problem is not one of U.S. industry inaction; it is one of a more aggressive level of foreign action derived from government policies highly supportive to industrial aerospace objectives.

In the United States, basic research toward important technology developments (e.g., improvement of fuel efficiency) is funded by industry, the National Aeronautics and Space Administration and the Department of Commerce. However, before aircraft can incorporate such improvements, very extensive validation programs are necessary. Industry has urged an increase in NASA aeronautics R&D programs, particularly those applicable to civil transports, leaving application developments to be funded entirely by industry.

The historical preeminence of the U.S. aircraft industry has rested upon three pillars: (1) technology leadership, (2) manufacturing and supplier capabilities, and (3) a large domestic sales base. At the present time, the first of these is in danger of being eroded away. In the words of former Treasury Secretary Blumenthal: "Our technological superiority is not mandated by heaven. Unless we pay close attention to it and invest in it, it will disappear." The aerospace industry's research and development budgets, in common with those of other industrial sectors, have been adversely affected by high tax rates, runaway inflation, and uncertainties associated with the present economic environment and federal policies. While the industry has introduced new technology aircraft it is also true that, in constant dollar terms, the aerospace industry reduced its R&D budgets by nearly 30 percent from the late sixties to 1979, in constant dollar terms. Although budgets were higher in the late seventies than they were mid-decade, they have never again reached the levels of the sixties. In large measure, the high level of R&D spending during the sixties led to the large export sales in the seventies and, on this basis, the reduction in spending during the last decade is a grim omen for the eighties. The United States aerospace industry is in serious danger of surrendering its superiority to overseas competitors and of repeating the experience of the steel and automotive sectors.

From the previous chapter it is worth noting that the development of new aircraft is a uniquely risky venture involving high initial R&D and tooling costs and lengthy payback periods. Financial success for U.S. manufacturers today requires the production of more than 400 aircraft of a single type. Escalating launch costs have resulted in financial risks greater than the net worth of even the largest aerospace companies. Further, the sales rates of individual models are difficult to predict and may be affected by poor timing of introduction (DC-7 and Convair 880), an unfortunate series of accidents (Lockheed Electra), or the bankruptcy of a major supplier (Rolls Royce, the L-1011). Indeed, of three wide-bodied aircraft initiated in the sixties only one has thus far proved financially successful.

Foreign governments are providing substantially greater incentives to their R&D establishments than the United States although funding is not greater in absolute terms. Nonetheless, as percentage of total government funding to increase industrial productivity, the European countries have been spending on about the same level as the United States in aeronautics and space.[3] And while the relative level of expenditures in the United States on aeronautics and space steadily decreased through the seventies, other nations were applying more R&D funding to specific civil projects (e.g., A300-A310 development). Incentives offered by other nations include West Germany's tax-free grants for up to 7.5 percent of the investment in R&D facilities and tax allowances of up to 50 percent for assets used for research. Japan provides low-interest loans to targeted industries and a 25 percent first-year depreciation allowance for new R&D

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[3] Aerospace Industries Association, *Research and Development: A Foundation for Innovation and Economic Growth*, (Washington, D.C., 1980), pp. 31–32.

equipment. The terms of the loan stipulate no repayments until the profitability of the venture is assured. Both Britain and Canada have instituted extensive programs to spur R&D spending, including immediate write-offs of new equipment investments.

Although it is crucial for the future health and development of the U.S. economy, the United States unfortunately has no long-range policy for R&D, innovation and technology. The United States appears to be years behind its principal competitors in embracing the national goals of innovation and productivity and recognizing the concept of a business-government partnership in R&D. In a recent study, the Aerospace Industries Association found that industries that perform federally-funded R&D excell over other sectors of the economy in worldwide trade.[4] R&D incentives to industry, then, are an investment in the U.S. economy's performance in future world trade competition.

U.S. Export Incentives

U.S. Government export expansion incentives fall into four main categories: (1) promotional programs, (2) assistance to small and minority-owned firms, (3) the improvement of trading opportunities through international trade agreements, and (4) financial incentives. Commercial jet transport and related supplier marketers can find assistance only in the last two categories. Each has particular long- and short-range significance to the industry.

International trade agreements—U.S. negotiators, backed by assistance from the civil aircraft industry, were particularly aggressive during the last round, the Tokyo Round, of negotiations on the General Agreement on Tariffs and Trade (GATT). The fruit of their efforts was an agreement among 14 nations on a Civil Aircraft Trade Code. All 99 participating countries were invited to sign, but to date only the United States, Canada, the nine nations of the European Economic Community, Switzerland, Japan, Norway, Sweden, Czechoslovakia, and Romania have elected to do so. The Aircraft Agreement eliminates import duties on civil aircraft and related parts in the signatory countries, as well as a variety of non-tariff barriers to free and competitive trading opportunities. The agreement was reached in April 1979, became U.S. law in July and went into effect January 1, 1980.

The Aircraft Agreement is complex and covers all aircraft (other than military) and flight simulators but excludes aircraft-related ground equipment. The focus of attention when the agreement was drafted was eliminating non-tariff barriers to equal competitive opportunities. Specifically, the Agreement covers:

1. *Technical standards*—Designed to discourage discriminatory manipulation of product standards, testing, and certification.
2. *Government-directed procurements*—Designed to prevent government influence in local procurement decisions by directives, conditional procurements, offering of inducements, or threats of sanctions.
3. *Foreign purchase inducements*—Designed to prevent manufacturer-based governments from offering or threatening non-aircraft-related action to/upon foreign governments which might influence competitive equality.
4. *Trade restrictions*—Designed to preclude use of quotas or restrictive licensing practices.
5. *Subsidies and countervailing duties*—Adopted the current GATT Agreement on the subject and included a statement of intent on civil aircraft pricing methodology.
6. *Annual review and dispute settlements*—Designed to promote communication among the signatories and establish a mechanism—the Committee on Trade in Civil Aircraft—for generating rulings and recommendations.
7. *Acceptance, accession, withdrawal and amendment procedures*—Adopted standard GATT provisions.

The Aircraft Agreement represents a compromise among differing and competing interests. The United States immediately eliminated a 5 percent duty on all aircraft-related imports as a visible demonstration of intent. Concessions by other signatories were all related to non-tariff issues, and the U.S. aircraft industry anticipates some substantive difficulties may arise over unresolved issues, as well as questions of interpretation with the Agreement as signed. Eighteen months, for example, were required to resolve United States-Japanese differences of interpretation over the Government Procurement Code. The stumbling block was a potential $3.3 billion telecommunications procurement planned by Nippon Telephone and Telegraph Company. The U.S. government is now watching carefully the manner in which the procurement is handled as an indication of whether the Japanese are serious about opening up their markets for high-technology products to foreign competition. With assertive enforcement of the Agreement and U.S. manufacturer vigilance of the market, this opportunity could have been lost.

Foreign government involvement in the civil aircraft industry is a sensitive issue with U.S. manufacturers. The fulfillment of the spirit and letter of the agreement by behind-the-scenes resolution of problems is essential if the agreement is to be truly effective within a reasonable length of time. In addition, amendments to the agreement are inevitable in order to meet changing world trade conditions and other trade-related bilateral and multilateral agreements which may occur. For example, the existing Aircraft Agreement could be affected by OECD negotiations over aircraft financing terms (pages 44 and 48).

The modification of procedures and administration for handling the customs duty changes agreed to in Tokyo are now underway. The need to speed delivery of spare parts through customs operations is not being met, as intended by the agreement, due to delays in administration in many parts of the world. Similar situations exist with respect to the standards, trade restrictions, and subsidy areas of the agreement. There is also a need to expand the agreement's coverage of spare parts. The time and dedication necessary to resolve such problems are not expected to be forthcoming without some urging by the U.S. government.

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[4] Ibid.

While much, then, was accomplished by the GATT Agreement, it is but a foundation upon which to build operating systems. In order to insure the benefits which can and will accrue to the industry from this agreement, vigorous government and industry enforcement is essential. Industry Sector Advisory Committees (ISACs) have been established to provide the U.S. government with data, and analytical and policy recommendations. The U.S. government, however, is moving very slowly to respond.

Financial incentives—U.S. government financial incentives to expand export marketing, which assist the civil aircraft industry, are limited to the very politically controversial DISCs (Domestic International Sales Corporations), Export-Import Bank financing, and some funding of basic research and development. DISCs have been subject to attack from U.S. and foreign interests since 1975 and, as a result, a reduction in the scope of eligibility has been implemented. The future of the DISC as an export incentive is in doubt due to Congressional criticism of the allowed deferral of taxes on foreign sales income, and a concerted effort by EEC countries through the GATT to eliminate DISC benefits.

The Export-Import Bank (Eximbank) was chartered by Congress in 1934 and has operated ever since as a self-sustaining, wholly-owned government corporation. The U.S. Treasury provided the bank with $1 billion in capital. By 1980, profits from Eximbank operations had allowed it to pay back to the Treasury in excess of $1 billion in the form of dividends and built-up contingency reserves of some $2 billion.

The Eximbank facilitates U.S. civil aircraft exports by providing direct loans, loan guarantees and political risk insurance. Foreign countries have similar institutions such as HERMES (Germany), COFACE (France) and the Export Credit Guarantee Department (ECGD) in the United Kingdom. The Eximbank is charged by Congress to meet competitive financing offerings, but it is also expected to be profitable. Currently those objectives cannot be attained, and the Eximbank is in operating deficit for the first time in its history.

The small differences in operating costs between aircraft can often be offset by attractive financing. To avoid a self-defeating export credit war, the aircraft-exporting nations entered into the "Standstill Agreement" in 1975, which limited officially supported export credits to 90 percent of the purchase price with repayment term set at 10 years (12 years for leases). The Standstill Agreement is silent on interest rates. A recently concluded interim arrangement covering Airbus and U.S. aircraft established minimum interest rates (U.S. dollar—12 percent; French franc—11.4 percent; German deutsche mark—10 percent) and limited the cover to 42.5 percent for Eximbank type credits, 62.5 percent for European credits. (Average term of loan is equivalent because of different repayment requirements.) Participation in excess of the 42.5 percent on Eximbank financing would be limited to guarantees. This interim agreement, like the Standstill, continues the repayment term at 10 years.

Since all countries that manufacture aircraft currently subsidize the financing of their aircraft exports, such subsidies provide no advantage to any exporter and are an unnecessary drain on national treasuries. Eliminating subsidies as part of an international agreement would permit governments to reallocate their resources to priority domestic needs.

The political justifications and economic rationale advanced by many countries for subsidizing exports are discussed elsewhere. The best and probably only alternative to a credit war, however, is an international agreement between all aircraft and aircraft-engine exporting countries to eliminate financing as a competitive element in aircraft sales.

A final agreement on export financing based on the current interim agreement must involve private sector financial institutions worldwide. These capital/money markets are fully capable of providing the financing required to support both U.S. and foreign aircraft exports in any currency desired by the prospective borrower. They can also provide financing more commensurate with the expected useful life of the aircraft, which is 18 to 20 years or more. Access to, and terms of such financing must be available to support all exports on a non-discriminatory basis.

As a practical matter, it could cost a non-U.S. manufacturer more to access the U.S. capital/money market than it would a U.S. manufacturer. Conversely, U.S. manufacturers could face similar cost differentials in accessing capital/money markets in other countries. Therefore, to achieve non-discriminating long-term financing, official export credit agencies may need to neutralize the cost differential caused by accessing off-shore funds. Neutralizing such cost differences should not be construed as an unfair trade subsidy since its only purpose would be to rectify market imperfections and ensure parity of financing terms to prospective borrowers. The final agreement on export financing should result in longer-term, private sector funding with equal access, free mobility and full parity for all aircraft manufacturers. In the interim, however, it is most important that all competitive financing offers be met so that equipment is selected on the merits of the product.

U.S. aircraft export sales have relied heavily upon Eximbank financing in recent years. A small fraction of a percentage difference in export financing offered by the United States against that offered by the multinational European consortium of banks, led by the French, can make a significant difference in the total operating cost of a jet transport over the period of the loan. U.S. capital costs have been rising over the last 30 years, and the increase in the last several years has been precipitous. As a result, U.S. manufacturers have been at a serious disadvantage when competitive foreign export financing programs, which provide fixed rates, have been compared to U.S. export financing programs, which include commercial bank fluctuating rates combined with Eximbank fixed rates. The U.S. "blended" rate has been significantly higher than equivalent foreign competitive offers resulting in substantially different capital costs. For example, with the prime rate above 15 percent, the difference between a foreign competitive fixed rate offer at 8¾ percent and a U.S. blended rate could range between 300 and 400 basis points. For a 10-year loan this translates into additional capital costs of between $15.8 to $26.3 million for each $100 million of financing. (See Table 9).

U.S. civil aircraft manufacturers offer very competitive products with respect to performance, price, economic efficiency in operation, and airline passenger appeal. But in the course of shopping for future fleets, customer airlines are looking at total operating costs, including debt financing and its service costs. U.S. jet transport manufacturers have been economically disadvantaged in an otherwise open competition unless export financing comparable to foreign government offerings was available from Eximbank. Even recent agreements on minimum interest rates do not guarantee parity to U.S. firms.

TABLE 9

CAPITAL COST DIFFERENCE
BETWEEN U.S. BLENDED AND FOREIGN FIXED RATES
1980
($100 Million, 10-Year Term,
Semi-annual Payments)

Interest Differential Percent	Cost	Present Value of Cost at 10 Percent Discount
1	$ 5,250,000	$ 3,768,895
2	10,500,000	7,537,790
3	15,750,000	11,306,685
4	21,000,000	15,075,580
5	26,250,000	18,844,475

U.S. Export Disincentives

Despite declarations to the contrary, the U.S. government has over the years persisted in its view of export business as a privilege granted at the pleasure of the government, and removed at its displeasure with a buyer nation. Additionally, export promotion and market development through government programs have been oriented toward small to medium-sized enterprises. These policies indicate that our government has overlooked the fact that large export businesses offer substantial export markets to thousands of small and medium-sized suppliers. Without these markets, the economy will lose sales, profits, future capital, employment, tax revenues, and export earnings.

Today the United States is involved in an economic struggle. Foreign competition for traditional U.S. manufacturer markets is becoming more intense both at home and abroad. The United States is no longer a monopolistic influence in world trade; other markets are nearly as large, other sources of supply offer comparable quality, performance, price, and service in a wide range of products. Over the last 30 years, U.S. foreign assistance has helped developing nations attain economic independence. Many prosper under the growing trend of interdependent economies and all of our trading partners regard exporting as a necessity of economic good health.

In the fall of 1978, President Carter called for export expansion via assistance to business to encourage aggressive competition. ". . . Equally important," he said, "will be the reduction of government-imposed disincentives and barriers which unnecessarily inhibit our firms from selling abroad . . ."

These disincentives include:

Administrative delays—U.S. corporate executives have ranked administrative delays and regulatory impediments first among U.S. disincentives that impact international business.[5] Delays and uncertainty relating to procedures and regulations produce discouragement and higher costs, damaging both the inventiveness and competitiveness of U.S. products and services.

Unilateral controls and impediments—When the United States is the only nation applying controls or erecting impediments to exports, it gives away sales opportunities to foreign suppliers.

Foreign policy restraints—Foreign policy restraints, which amount to economic sanctions—a form of boycotting—without the cooperation of other nations, have also taken their toll of export growth.

The United States Congress has chosen to take a strong stand against the propagation of international terrorism and the denial of basic human rights and the campaign for human rights has become institutionalized in several pieces of legislation. History has shown, however, that unilateral sanctions have failed to achieve their objectives, even when foreign availability of substitute products was much more limited than is now often the case. Over the last five years, the effectiveness of human rights considerations in granting economic assistance, military aid, export loans and investment guarantees, and in exporting some agricultural products and providing Peace Corps services has been mixed, at best. Further, foreign nations view U.S. human rights legislation as fundamentally naive and bordering on violation of international law.

Ironically, the use of economic sanctions may well worsen conditions for those it is intended to benefit. A study of boycott/embargoes imposed since 1940[6] indicates that these sanctions tend to harden the resolve of the opposition. The loss of economic aid from the United States usually strikes at the poor and disadvantaged, rather than at the ruling body of a country. And at home, when export sales are denied, job opportunities are inevitably reduced; again, the first and hardest hit are the economically disadvantaged.

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[5] International Management and Development Institute, *Keeping Competitive in the U.S. and World Market Place* (June, 1979).

[6] Henry Benson and Robert Gilpin, *Evaluation of the Use of Economic Sanctions to Promote Foreign Policy Objectives* (April, 1979).

The Export Administration Act of 1979 reflected Congressional concern for limiting the use of unilateral sanctions in foreign policy differences to those occasions where greater success would be more likely than before. The Act prescribed criteria for imposing, extending or expanding foreign policy export restraints. Additionally, it stated that consideration must be given to the foreign availability of comparable products, the likely effect of the sanctions upon U.S. competitiveness, the perception of faltering supplier reliability likely to be engendered, and the national economy. The likelihood of a sanction achieving its intended purpose, given the availability of comparable foreign products and technology must also be considered. Department of Commerce regulations initially issued January 1, 1980, failed to reflect these criteria where commercial aircraft and helicopters are concerned. Instead the regulations went beyond the law to specify the dollar value of export transactions to be reviewed. Meanwhile, from the time deliberations over the legislation began in 1978 through 1980—some eighteen months—licenses for $500 million in exports of commercial aircraft, engines, and spare parts were denied or postponed.

While the products of U.S. commercial jet aircraft manufacturers can compete very effectively in terms of efficiency, performance, quality, service and price—if price reflects real cost—valuable markets can be lost due to foreign policy export restraints, and the reputation of an unreliable supplier is spreading in world markets for many U.S. products and services because of prior experience with restraints.

Antitrust legislation—While some 30 countries have antitrust laws, the U.S. legislation is the oldest and most vigorously enforced. Domestically, these laws have been very effective in promoting competition; their application in international business, however, has set the United States apart from most of its trading partners, and disadvantaged U.S. business in competing for export markets.

While the impact of antitrust legislation on the aerospace industry may be minimal, many U.S. businessmen perceive the extraterritorial application of these laws as a major export disincentive. It is alleged that no other government restricts its commercial enterprises to such an extent in setting up joint ventures, making consortium bids, dealing with state trading companies, or negotiating with commodity cartels as does the U.S. government. No other government provides so few guidelines for what constitutes acceptable business conduct abroad or is so eager to pursue antitrust enforcement. No other government works to prevent mergers and cartels in overseas sales and investment ventures as does the United States. The [illegible] Congress is, however, considering changes in the current anti-trust laws.

The Webb-Pomerene Amendment to the Sherman Antitrust Act does allow firms to join together for bidding and cost sharing if the activity does not adversely affect competition in this country. Large firms have made the greatest use of Webb-Pomerene provisions, but have been increasingly loathe to be aggressive in this effort, due to an uncertainty created by recently changing interpretations of criteria for corporate behavior overseas. The Export Trading Company legislation before the 97th Congress is designed to help counteract this situation and broaden incentives for participation in export trade organizations. Antitrust laws are not themselves credited with many lost export opportunities but when the uncertainty caused by their interpretation and application is combined with the burden of anti-boycott strictures and the Foreign Corrupt Practices Act, an export venture may seem hardly worth the trouble. On balance, it would seem that any restrictions on U.S. firms' activities not equally shared by the foreign competition would tend to disadvantage U.S. exporters.

The Reagan Administration has indicated an understanding of the problems which now handicap U.S. exporters and has issued a statement on trade policy setting forth these fundamental objectives:

- Restoration of strong non-inflationary growth to facilitate adjustment to changing domestic and international market conditions.
- Reduction of self-imposed export disincentives, and better management of government export promotion programs.
- Effective enforcement of U.S. trade laws and international agreements.
- Effective approach to industrial adjustment problems.
- Reduction in government barriers to the flow of trade and investment among nations, with strong emphasis upon improvement and extension of international trade rules.[7]

At this time, the role of the government in the commercial jet transport industry is undergoing change. It is to be hoped that this leads to a restoration of U.S. world market competitiveness, as afforded in the terms of the GATT agreement.

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[7] Statement of Ambassador William E. Brock, U.S. Trade Representative, before a Joint Oversight Hearing of the Senate Committee on Finance and the Senate Committee on Banking, Housing and Urban Affairs, July 8, 1981.

EMERGING INTERNATIONAL COLLABORATION

In the last few years, with the restructuring of competition in the aircraft market, changes in the world marketplace and increases in program costs, some U.S. aerospace companies have entered new relationships with foreign companies. These U.S. firms have made collaborative agreements with foreign firms to gain market share and decrease financial risk. In fact, it must be noted that 30 to 35 percent of the Airbus A300 is of U.S. manufacturing content. A look at recent history will place the issue in better perspective, providing insight into the imperatives that have developed and what lies ahead. Specifically, it is appropriate to consider what has happened to U.S. military aerospace sales over the last 20 years, a period during which the European aerospace industry has revived, grown and become aggressively competitive. Recognizing that the geopolitical environment of Europe is sensitive to many and varying factors, the European market will remain sizable and significant and its military aerospace sales trends should provide a reasonable lead-indicator of what could happen to commercial aircraft sales.

In the United States, military aerospace export sales as a percentage of total exports have remained relatively constant over the last 20 years (Table 10). However, total U.S. exports as a portion of the total free world export market have declined from 31 percent in 1960 to 22 percent in 1979 (Table 11). Another view of this same situation can be seen in Figure 22. Total U.S. aircraft sales show that the military aircraft export segment has remained relatively constant at an average 10 percent over the last thirty years. In the same time period, however, civil aircraft export sales have increased from less than five percent to 40 percent of total U.S.-manufactured aircraft sales. Both sets of data clearly indicate that military export aircraft sales have not expanded significantly in the last twenty years. Although a much more detailed analysis would be required to identify all of the factors involved, the most obvious has been the purchase of "home built" aircraft by European countries, coupled with U.S. government export restrictions. In spite of the more than 300 F-16s ordered by NATO countries from the United States in the mid-seventies, the 800 Panavia Tornadoes, 400 Alpha Jets and 400 SEPECAT Jaguars on order or delivered represent the reality of indigenous European competition altering the trend of historic sales curves. It is probable that this trend will be continued with the advent of the proposed Eurofighter.

What has happened with respect to military export sales may be a precursor of events in the commercial arena. Although worldwide sales of U.S. commercial aircraft are still strong, Airbus Industrie competition has caused U.S. market share to decline. There is a high probability that this trend will continue through the next decade.

Factors Influencing Joint Ventures

The military and commercial objectives of some foreign nations—which include increased industrial development and the creation, stabilization or increase of employment—have led these nations to develop advanced technological capabilities. Their efforts have encouraged the formation of joint venture agreements with major aerospace companies,

TABLE 10

U.S. EXPORTS
TOTAL AND MILITARY AEROSPACE
1960–1979
(Billions of Dollars)

	1960	1970	1976	1977	1978	1979
Total Exports	$20.6	$42.7	$115.1	$121.2	$143.6	$181.6
Military Aerospace Exports	$ 0.6	$ 0.9	$ 2.2	$ 2.5	$ 4.0	$ 4.1
Military Aerospace as Percentage of Total	2.9%	2.1%	1.9%	2.1%	2.8%	2.3%

TABLE 11

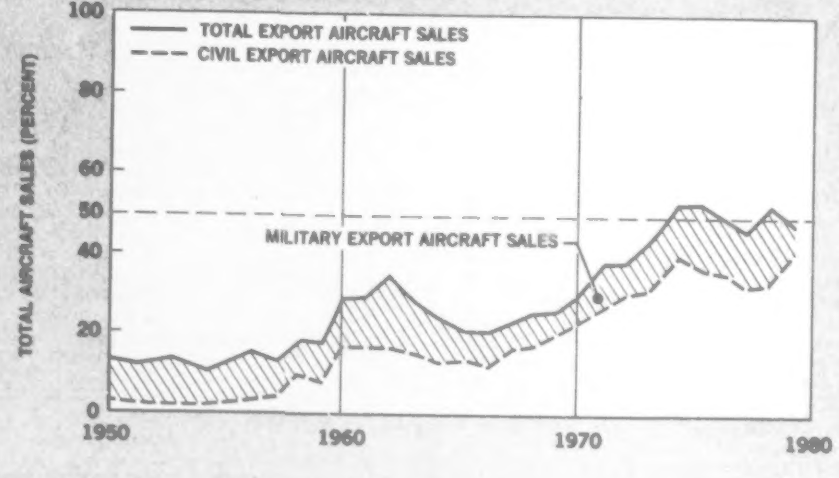
TOTAL EXPORTS AND EXPORTS AS PERCENTAGE OF TOTAL FREE WORLD EXPORT MARKET FOR THE UNITED STATES AND MAJOR INDUSTRIAL NATIONS
1960–1979
(Billions of Dollars)

Year	United States	France	West Germany	Italy	Netherlands	United Kingdom	Japan	Canada
1960	20.6	7.2	11.4	3.6	4.0	10.4	4.1	5.4
1970	42.7	18.1	34.2	13.2	11.9	19.6	19.3	16.1
1979	181.6	100.6	171.7	72.2	63.6	86.3	103.0	55.8
PERCENTAGE OF TOTAL FREE WORLD EXPORTS								
1960	30.9%	10.8%	17.1%	5.4%	6.0%	15.6%	6.1%	8.1%
1970	24.4	10.3	19.5	7.5	6.8	11.2	11.0	9.2
1979	21.8	12.1	20.6	8.6	7.6	10.3	12.3	6.7

SOURCE: National Aeronautics and Space Administration, Government/Industry Affairs Division, *The General Economy and the Aerospace Industry* (Washington, D.C., July 1980).

FIGURE 22

CIVIL AND MILITARY AIRCRAFT EXPORT SALES AS PERCENTAGE OF TOTAL AIRCRAFT EXPORT SALES OF U.S. MANUFACTURERS
1950–1979



both U.S. and foreign. An interesting facet of the success of European-produced military aircraft is that all three aircraft mentioned above are products of multinational joint ventures: Panavia, which produced the Tornado, is composed of British Aerospace, Messerschmitt-Boelkow-Blohm and Aeritalia; SEPECAT, which created the Jaguar, is a joint venture of British Aerospace and Dassault-Breguet; and Dassault-Breguet and Dornier build the Alpha Jet.

Japan has also encouraged transnational partnerships. A prime example is the linking of Ishikawajima-Harima Heavy Industries, Kawasaki Heavy Industries and Mitsubishi Heavy Industries with Rolls Royce to develop the RJ500 engine. This venture is a fifty-fifty partnership. Japan's MITI (Ministry of International Trade and Industry) is reportedly loaning approximately three-fourths of the nonrecurring costs in the early stages of development. MITI's contribution will be reduced to two-thirds once the engine is committed to production. Then, until the engine begins to return a profit, MITI will continue to provide half of all Japanese costs. MITI loans will be repaid only when the engine is profitable.[1]

This financial arrangement illustrates one of the factors that makes foreign cooperation so attractive and, at the same time, makes foreign competition a major concern for U.S. companies. Interest-free, deferred-payment loans for development programs, and indigenous markets (armed forces or nationalized airlines) offer major advantages and risk reduction that enhance cooperative associations among countries.

Another consideration affecting development of collaborative agreements is the relative condition of the companies that may be involved. There are, basically, two categories of companies that pursue such ventures. The first consists of companies that, of political or economic necessity, are eager to form transborder partnerships: those that want to acquire advanced technology capabilities and those that must join a cash-rich partner in order to survive. The Japanese are an example of the former. The McDonnell and Douglas Aircraft union in the late sixties, was an example of one entity surviving by joining a strong partner. This survival syndrome will most probably be a continuing factor for some U.S. and European companies within the foreseeable future. In a second category of candidates for collaborative agreements are larger and stronger companies that initiate relationships to gain market share and/or reduce risk.

A powerful influence in favor of cooperative ventures has also emerged from the requirements of security within the Western Alliance, with the support and encouragement of the trend by the United States government. The United States, particularly the Department of Defense (DOD), has created and continues to create situations in which manufacturers are channeled into international agreements. Influencing these ventures are the need for hardware commonality, most often within NATO, and for cost reductions of sophisticated military hardware through volume production. As a result, there have been an increasing number of collaborative military projects in Europe and Japan while, in the United States, the Department of Defense has also pushed for NATO RSI (Rationalization, Standardization and Interoperability) or, more simply, for weapons collaboration.

U.S. companies have come to realize that in order to participate in this international defense market they must increasingly collaborate with foreign companies, many of which are either owned or strongly influenced by their governments. For U.S. manufacturers, "offset" required by foreign governments has frequently become an integral part of selling efforts. Offsets consist not only of the seller's buying foreign products to partially offset his sales—and, therefore, to offset the balance of trade gains—but may also involve the manufacture, under license, of part or all of a seller's product within the foreign buyer's country. Such arrangements force a cooperative relationship between U.S. and foreign manufacturers who, normally, would be in competition.

While the U.S. government has set the stage for collaborative manufacturing arrangements, still other factors have tended to encourage transborder partnerships:

- Some foreign countries are developing their own aerospace capabilities through the conscious strategy of joining either with more advanced partners to absorb technology, or with other countries to create a synergism. The Airbus consortium is the best and most successful example of the latter approach to date and the RJ500 partnership between Japan and England's Rolls Royce could well be the next. Such strategies create a competitive atmosphere in which it becomes more difficult for weak/small companies to survive. At the same time, they set a standard and a pattern for others to follow.

- The sharing of costs of reseach and development, of launching engine and airframe programs, and of supporting and expanding production facilities is another major advantage of collaborative/risk sharing arrangements. Insofar as R&D is concerned, Figure 23 shows graphically that France, West Germany and Japan, as well as the USSR, all have maintained or increased spending on R&D as a percent of GNP while the United States has decreased spending. Even if the United States spends more in absolute terms than, for example, West Germany the trend is discomforting and reflects the decline in the federally-suported share of R&D from 56 percent in 1970 to under 50 percent in 1979. If this trend continues, and more R&D costs are borne by private firms, prices will increase and technological leadership will erode causing U.S. products to be less competitive. The possibility of sharing costs for expensive and risky R&D is a strong argument in favor of cooperative ventures with other countries.

With either engine or airframe development costs ranging between one and two billion dollars, cost sharing has tremendous appeal. In some cases, the oppor-

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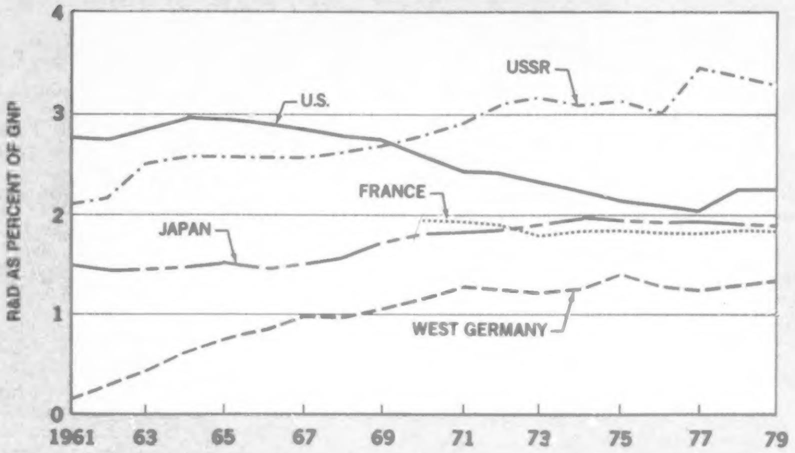
[1] *The Aeroplane Makers*, The Economist, (August 30, 1980), p. 5, Survey Section.

FIGURE 23

RESEARCH AND DEVELOPMENT EXPENDITURES
AS A PERCENTAGE OF GROSS NATIONAL PRODUCT
FOR THE U.S. AND LEADING INDUSTRIAL NATIONS
1961–1979



tunity to share expenses has undoubtedly made the difference between launching a program or not.

Recognizing the variability of U.S. aerospace production figures, it is clear that the decision to expand production capacity can be critical—particularly in view of the range and variety of jetliner programs currently in production or planned (Table 12). Companies face the difficulty of matching near-term increases in facilities requirements with long-term uncertainties and cyclic demand. One solution is the utilization of the existing production facilities of foreign partners in order to satisfy current expanded requirements.

- Cooperative ventures provide improved access to markets which previously may have been unavailable or restricted. Through joint marketing organizations, third world nations and markets with unilateral orientations toward specific foreign suppliers are potentially available to the previously excluded partner.

- Many foreign airlines are controlled by military officers influenced by the military regimes of their country. The United States has already lost a significant segment of its military export sales—much of it to foreign products. By inference, what is happening in the military area can be carried over to the commercial area when foreign airlines are under government control. Somewhat in this same vein, political risk is another element in export sales to foreign nations. In both of these cases, trade becomes a tool and, in certain situations, joint ventures can minimize risk and allow a unique marketing advantage.

- The trend toward collaboration is being given impetus by attitudes, policies and laws of the United States that, combined with inconsistent and unfavorable interpretation of policies, serve as export disincentives. A more complete discussion of this issue was presented in the preceding chapter.

Trend Toward International Cooperation

Risk sharing is a relatively recent phenomenon caused by huge development costs coupled with the inability of the marketplace—the airlines—to support the number of manufacturers that existed in the fifties and sixties. Today the development costs of new engines and new aircraft are measured in terms of *billions* of dollars. Payback periods for companies that develop new products exceed 10 years and

TABLE 12

CURRENT/NEAR TERM AND PLANNED PRODUCTION WORLD COMMERCIAL JETLINER PROGRAMS

Range	Type	Source	Model	Typical Number of Seats (Mixed)	Range (Miles)	Number & Mfg. of Engines	Initial Version Date Into Service
Current/Near Term Production							
Long Range	Wide-body	USA	747-200B	442	6000	(4)P&WA,[a] GE[b] or RR[c]	1970
			747SP	321	5800	(4)P&WA, GE or RR	1976
			747SUD*	486	6200	(4)P&WA, GE or RR	1984
			L-1011-500	246	5000	(3)RR	1979
			DC-10-30/-40	277	5400	(3)GE or P&WA	1972
		USSR	Il-86	234		(4)Kuznetscv	1980
	Standard body	USA	707-320B	147	5800	(4)P&WA	1958
			DC-8-71	220	4600	(4)CFMI[d]	1982
		USSR	Il-62M	140	5500	(4)Soloviev	1968
	SST	USSR	TU-144	140	4000	(4)Kuznetsov	1975
Medium Range	Wide-body	USA	L-1011-1	256	3900	(3)RR	1972
			DC-10-10/-15	277	4000	(3)GE	1971
			747SR	500	3000	(4)P&WA or GE	1973
			767	208	3400	(2)GE or P&WA	1982
		Europe	A300B4	251	3100	(2)GE or P&WA	1972
			A310	212	3100	(2)GE or P&WA	1983
			A300-600	263	3700	(2)GE or P&WA	
	Standard body	USA	727-200	145	2500	(3)P&WA	1964
			757	178	3500	(2)RR or P&WA	1983
			DC-9-80	137	2300	(2)P&WA	1980
		USSR	TU-154	146	3300	(3)Kuznetsov	1974
Short Range	Standard body	USA	737-200	100	2200	(2)P&WA	1967
			737-300	120	2400	(2)CFMI	1984
			DC-9-30	93	2000	(2)P&WA	1965
		Europe	F-28	85	900	(2)RR	1969
		USSR	YAK-42	120	900	(3)Lotarer	1977
Planned/Potential Production							
Long Range	Wide-body	USA	747 Stretch	500 +	5500	(4)P&WA, GE or RR	Mid-1980s
			DC-10-Super 30	327	5300	(3)GE or P&WA	Mid-1980s
		Europe	TA-11	226	6100	(4)P&WA	Mid-1980s
			TA-12	226	5120	(2)GE or P&WA	Mid-1980s
Medium Range	Wide-body	USA	DC-10 Super 10	277	4500	(3)P&WA, GE or RR	Mid-1980s
		Europe	TA-9	325	3200	(2)GE or P&WA	Mid-1980s
	Standard body	USA	7-7	150	1500	(2)CFMI, RR or P&WA	Late 1980s
			MDF-100	150	2200	(2)CFMI, RR or P&WA	Mid-1980s
		Europe	A320	150	1800	(2)CFMI, RR or P&WA	Mid-1980s
Short Range	Standard body	USA	DC-9 Derivative	110-120	2100	(2)CFMI or P&WA	Mid-1980s

* Stretched upper deck

[a] Pratt and Whitney

[b] General Electric

[c] Rolls Royce

[d] General Electric and SNECMA

the risk involved in each new venture is, in effect, the net worth of the company. Many of the major aerospace companies active in the fifties and sixties have had to retrench or reorient their businesses to adjust to market demand. This trend is expected to continue in the future and result in a probable reduction of the industry to even fewer companies. Thus, the natural forces of the marketplace are directing some companies toward some form of collaboration, e.g., subcontracting or risk sharing/license/joint venture agreements.

An additional element tending to create cooperation, as mentioned earlier, has been the demands of foreign countries for offset or shared production as a requirement for military purchases. With NATO defense requirements and procurement arrangements forcing companies to collaborate, the tendency to extrapolate from the military experience to civil programs is an additional pressure that creates a favorable atmosphere, if not encouragement, for joint relationships.

Given these factors, it is easier to understand the trend toward transnational cooperative ventures, beginning with the multiple inter-European companies created in the sixties and seventies to produce the Concorde, Tornado, Jaguar, Alpha Jet and Airbus aircraft. These ventures established the standard for multinational collaboration.

In the early seventies, Pratt and Whitney courted Rolls Royce in an aborted attempt to jointly develop the JT10D engine currently designated the PW2037. Pratt and Whitney later continued the successful JT10D development with MTU of Germany and Fiat of Italy. Pratt and Whitney also entered into extensive offset arrangements with European countries to secure the NATO sales of the F100 engine in the F-16 fighter aircraft. Although the JT10D bond with Rolls Royce was not consummated, there was an agreement in 1980 for collaboration on the military engine for the Harrier V/STOL aircraft (which, in turn, would be built under license by McDonnell Douglas in the United States).

Also in the early seventies, General Electric recognized the benefits, both in dollars and in marketing, for risk sharing programs and joined with SNECMA of France in the development of the CFM56 engine. This joint venture agreement between GE and SNECMA was followed by coproduction on the part of SNECMA of the larger CF6 engine for the European-produced Airbus A300/A310 aircraft.

The aircraft manufacturers have also established relationships with foreign companies:

- Recently, Fairchild Industries and SAAB of Sweden, as well as CASA of Spain and Nuritano of Indonesia, announced the joint development of commuter-sized aircraft.
- If funded, McDonnell Douglas will build the Advanced Harrier (AV-8B) under license for the United Kingdom's Hawker Siddeley.
- Douglas Aircraft subcontracts the manufacture of subsections for the DC-9 and DC-10 to foreign suppliers.
- At the current time, the Lockheed L1011 aircraft is offered only with Rolls Royce RB211 engines.
- In 1978, Boeing signed a program participation agreement with the Italians and the Japanese for design work and production on the 767.
- In 1981, McDonnell Douglas and Fokker of the Netherlands announced an agreement to explore co-production of a 150-seat transport, the MDF-100.

In considering the trend toward international collaboration, there is a need for caution regarding inferences about the nature of the aerospace export market. It must be fully appreciated, for example, that the agreements of today and those of tomorrow will not necessarily involve the same partners. A look at the history of the many consortia formed and dissolved in Europe over the last twenty years makes it reasonable to expect that the relationships existing in 1980 will not be the same as those of 1985. In addition, not all major U.S. aerospace companies are involved in foreign partnerships to the same degree. Foreign competition, then, remains an important issue for an industry in which rival firms and nations risk very high stakes for a limited number of commercial aircraft sales.

Technology Transfer

Possibly one of the areas of greatest controversy concerning collaborative arrangements with foreign partners is the consideration of technology transfer. This can best be addressed by looking at two alternative approaches to the issue. One is the complete control of technology transfer by the U.S. Government. Essentially, this is the current arrangement with cognizant government agencies directing when, and what, specific information can be transmitted to foreign countries and companies. A second approach would eliminate most of the bureaucratic burden involved in the current process. It would establish a modified free enterprise system: The government would establish a general policy or criteria for a specific application, and the applicant would present the impact of the technology transfer for an identified critical timeframe.

The obvious rationale for the first system is national security, with an implied attitude that industry is driven only by the shortsighted perspective of near-term profits. The second approach is based on the tenet that long-term survival and growth are the primary drivers for U.S. industry. It then follows that technology transfer by individual companies can be controlled and directed by their sense of responsibility—not only to their industry but, most importantly, to themselves. Few corporations do not realize and appreciate the long-term danger of providing advantage to an aggressive competitor.

The factor of critical timeframe deserves careful attention. Even if it takes longer than one normal innovation cycle for a foreign competitor to use transferred technology to its advantage—and this creates no threat to the company or industry that provided the technology—the reorientation of that technology from one foreign industry to another, or from one application to another, remains a significant consideration. But even under a system of total government control, all possible combinations of technology utilization cannot be foreseen.

In the late fifties, for example, a U.S. aerospace firm established a licensing agreement with a Japanese company, Kawasaki, for a production package which included tooling designs. Within 10 years, Kawasaki was competing successfully in an entirely different product line—but one which depended upon machine tooling—against American companies. It is only possible to guess at the contribution of the initial licensing agreement to Kawasaki's success. More importantly for the aerospace industry, however, this same Japanese company is currently a partner with Rolls Royce in developing the RJ 500 turbofan engine. It is most probable that the development of the Japanese firm's technical production capability was evolutionary, but the question remains: Did the original technology transfer accelerate the process, and to what extent?

The issue of technology transfer obviously involves many subtleties and complexities. Among them is the benefit of two-way technical communication. Although an innovational process has historically characterized the U.S. aerospace industry and resulted in a continuing stream of new developments, products and services, it is not inevitable that the pattern will continue. It is important to remember that much current, advanced aerospace technology including the supercritical airfoil, the helicopter, jet engine and swept wing was not invented in the United States. Within logical limits, it is possible to argue that if the transfer of today's technology results in the eventual superiority of a foreign company, then the transfer probably only accelerated the inevitable. As T.A. Wilson, Chairman of the Boeing Company, has commented: "Technology transfer, in fact, has always been a two-way street and we can hardly afford to stop technical communication."

Another interesting twist to the technology transfer issue develops from the fact that current U.S. policy dictates no technology equal or superior to available military technology be exported. Because of the reductions in military R&D and procurement funding that took place over the past decade, however, there are many instances in which civil technology is superior to comparable military technology. The readily evident examples are navigation systems, the application of composite material in airframe components, and the use of active flight controls on the Lockheed L-1011. The fact that civil use precedes or supersedes military applications, should not preclude the exportation of these technologies. Obviously, industry has the obligation to exercise constraint in transferring developmental and production capabilities in these areas, but the exportation of civil manufactured products should be unconstrained by the government.

Recognizing that controls will be retained in any case, there is one element of transferrable technology from which all constraints should be removed and that is safety-related technology. There should be no restraints on freely providing this type of capability to other countries. It is the humane course of action; moreover, if advanced safety equipment is available to every airline then overall air safety is improved for both U.S. airline operators in foreign countries and foreign operators in the United States.

In much of the controversy concerning technology transfer, emotion and prejudice play a major role in forming opinions and biasing viewpoints. It is clear that timeframes and cross-industry applications have to be carefully assessed, if possible, in evaluating the effects of a technology transfer. There is, however, a fundamental, overriding question to be answered: If a foreign competitor is provided a technology it does not have but can use effectively in a relatively short time, will the transfer give it the ability to successfully compete against the U.S. companies? If the answer is yes, then, without mitigating circumstances, there should be no transfer. Still, as in most interactions, there are aspects that modify otherwise straight-forward perceptions. Was, for example, the licensed production of the F-104 in Europe a primary cause of the European aeronautical industry's redevelopment in the sixties—or did it merely accelerate evolution of a capability that had begun prior to World War II, was almost destroyed by the war, but which would have ultimately re-emerged in any event? In this case, politically encouraged technology transfer did not cause the re-emergence of a powerful competitor; it contributed to an inevitable development. (Interestingly, Lockheed Corporation, which participated in the resurgence of the European aeronautical industry, is licensee for the Alpha Jet in the United States, if it is selected as the U.S. trainer.)

The critical cause and effect criteria by which the issue of technology transfer must be judged often has to be applied with convoluted logic. For example, could an individual U.S. company have prevented the development of the Airbus Industrie's A300? Foregoing an extended point and counterpoint analysis, and weighing the role of predatory pricing policies and directed nationalistic buying, it is most probable that the A300 could not have been prevented. The requirement to succeed on the part of Airbus and the parent countries was stronger than the desire to prevent it. Given that Airbus could not have been prevented from achieving the market success that it has, what follows? What about the competition for second-tier items such as electronics and powerplants? If a U.S. company cannot successfully exclude foreign competitors, is it not justified in participating in a foreign program in order to minimize further competitive losses? The same logic can be applied to the provision of equipment, services, and technology.

It must be remembered that, with few exceptions, equivalent alternatives to U.S. products and services are available from foreign sources.

THE UNITED STATES AERONAUTICAL INDUSTRY

The Airline Industry

The U.S. commercial airline industry is a major customer for the air transport industry, although trends in passenger travel and air freight shipment have placed foreign sales ahead of domestic sales as a source of earnings. In 1979, U.S. scheduled airlines enplaned 317 million passengers, up from 172 million passengers in 1969—an increase of over 84 percent. These airlines had operating revenues of $27.2 billion and about 341,000 employees, an indication of the size, scope and impact of the industry.

In 1980, the domestic U.S. airline industry experienced a downturn in traffic due primarily to the recession. After strong growth of 17.7 percent in 1978 and 12 percent in 1979, 1980 traffic declined 4.7 percent. Following this worst historical drop in airline traffic, the industry is expected to experience an average annual growth rate of 4.5 to 5.5 percent through 1994 (Figure 24).

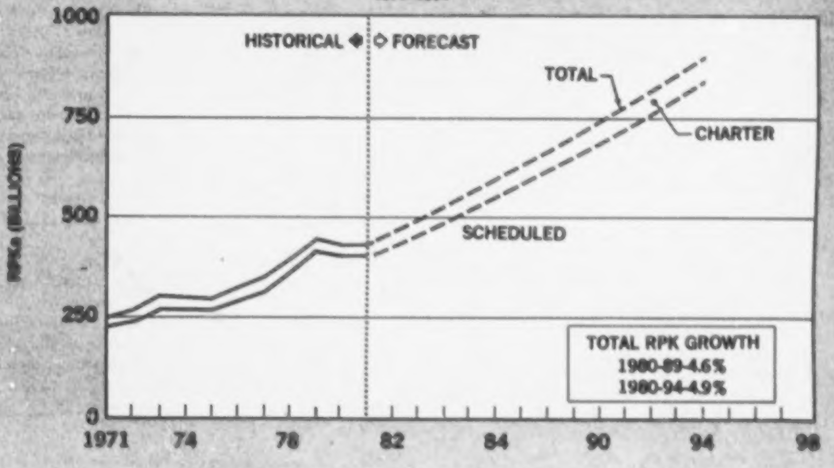
Deregulation—The legislated decrease of the Civil Aviation Board's (CAB) control of carriers, combined with CAB's own liberal attitude on competition, has created a new climate in the domestic airline industry.

Airline deregulation has caused new carriers to enter the market and established carriers to explore new routes. As a result, despite escalating fuel prices, fare discounting remains widespread. Orders for new aircraft remained relatively high in the first half of 1980, but fell off sharply after June, due mainly to the recession and falling traffic.

The short-term effects of deregulation may be highly chaotic for the airlines, and may result in an increasing number

FIGURE 24

U.S. PASSENGER TRAFFIC—AN ANALYSIS OF 36 AIRLINES
1971–1994



of mergers, as well as some airline failures. In the longer term, the effect upon traffic should be minimal, however, since people will continue to travel by air. Deviations may occur as some airline programs stimulate traffic and, conversely, as sharply increased fares due to high fuel and labor costs may dampen growth.

There are a few other possible results of deregulation:

- Continued intensive airline competition could lead to greater localized domestic capacity for some communities. As an example of the possible trend, Eastern, World, Pan Am and Capitol have joined American, TWA and United on the Los Angeles-New York run.
- Competition may create more direct service. The number of new routes certificated by the CAB under deregulation has been very large (2,500 by July 1979, according to an International Air Transport Association study). Obviously, most of these new routes have not been serviced; it is known, however, that trunk carriers added service on 336 domestic city-pairs between July 1978 and July 1979. In addition, some smaller U.S. cities have realized increased frequency of service since deregulation. In Bakersfield, California, for example, seven daily flights to and from Los Angeles and San Francisco increased to 19 following deregulation. This fragmentation of the market could lead to a demand for a smaller capacity aircraft.
- A reduction in competition during the period of adjustment to deregulation might not result in a need for additional aircraft, but lead rather to reduction of frequencies, elimination of discount fares, and fewer available seat miles.
- Efforts to alleviate airport congestion by auctioning slots or using differential fees could favor wide-body aircraft. The greater the cost to land at a popular time, the more attractive it becomes to spread these costs over a large passenger load.

It is very difficult to predict the longer-term effects of deregulation on the airline industry. While deregulation has led to overcompetition (and price cutting) and overexpansion of some routes (and lower load factors), it is not the only factor involved in the airline's current financial problems: The 1980 recession cut traffic, and escalating fuel costs contributed to a sharp increase in costs. However, deregulation and the airlines' reactions to it have been major contributors to loss of profits. Table 13 presents the financial standing of the trunk carriers in 1979 and 1980 and the difference between the two periods.

Obviously, the airlines cannot continue in this fashion. The end of the recession, renewed growth in traffic (and load factors) will reduce these losses. In fact, the 1981 air traffic controllers strike may to some extent enable the airlines to recoup through improved load factors generated by flight cutbacks. In the end, however, the airlines must learn to live with deregulation. This may involve further mergers but most certainly it means a deemphasis of cutthroat competition, and higher ticket prices for the consumer.

TABLE 13

U.S. TRUNK AIRLINES OPERATING PROFIT AND LOSS
1979 and 1980
(Millions of Dollars)

Airlines	1980	1979	1980 Better (Worse) than 1979
American	$(85)	$ 5	$(90)
Braniff	(107)	(38)	(69)
Continental	(46)	(8)	(38)
Delta	164	124	40
Eastern	2	111	(109)
Northwest	(24)	56	(80)
Pan Am/National	(130)	48	(178)
TWA	(18)	(44)	26
United	(66)	(235)[a]	169
Western	(46)	18	(64)
Airline Total	(356)	37	(393)

SOURCE: *Aviation Daily; Aviation Week*

a Result of strike

It must be pointed out, nonetheless, that some believe deregulation is a blessing and that, without it, the airlines would be in still worse shape.

"Evidence is strong that airlines would have been a lot worse off in this year (1980) of soaring fuel costs and falling traffic had they not been deregulated. I'm not sure we could have handled it," according to Neil M. Effman, Vice President for Airline Planning at Trans World Airlines, Inc.

Senator Howard W. Cannon (D-Nev.), sponsor of the Airline Deregulation Act, said: "The system as a whole has gotten more efficient because airlines can put their equipment where it can be used best. Efficiency is what deregulation is all about."[1]

Time will tell which viewpoint of deregulation is correct. At the present, all routes will become open December 31, 1981 and all fare controls will expire January 1, 1983. The Civil Aeronautics Board will go out of existence on January 1, 1985. If during this period the airline industry remains in a turmoil and does not generate an adequate financial return, a shake-out in the industry could result in a reduced number of surviving companies. If the industry does not stabilize, a remote possibility is a return to some form of regulation.

Equipment plans—The U.S. airlines are going through a transitional phase brought about by deregulation and heightened by the 1980 recession. The recession may ebb in the near future and it must be assumed that the airlines will learn to live with deregulation or that some form of regulation will be reimposed. Future equipment plans, therefore, will be triggered by traffic growth, noise legislation, operating costs, financing costs, and the availability of capital.

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[1] "Flying a Risky New Route for United," *Business Week*, No. 2650, August 19, 1980, pp. 78-82.

Traffic growth—As mentioned earlier, U.S. airline traffic, after dipping slightly in 1980, will average 4.5 to 5 percent growth through 1990, and slightly higher thereafter. This growth creates a "capacity gap" that the airlines must fill with additional equipment. A Boeing study indicates that U.S. airlines will have to purchase approximately $35 billion worth of new equipment (in constant 1981 dollars) through 1990 merely to satisfy increased traffic growth. The $35 billion figure, it must be emphasized, covers growth only, no replacement. In this 10-year period (1980–1990) traffic growth will dictate an average annual investment of almost $3.5 billion for new equipment. It will also place a great strain upon the airlines to generate the profits necessary to pay for this capital equipment.

Noise regulations—In an effort to curtail noise levels, Congress passed a law on February 29, 1980, setting schedules for the retirement or modification of aircraft that do not meet specified noise requirements. The first stage of aircraft compliance must be accomplished by January 1, 1985.

Table 14 indicates the number of U.S. aircraft that did not meet noise regulations as of January 1, 1981. The table also shows that four years earlier there were over 500 more aircraft that did not meet the noise specifications.

Not all of the 1,283 aircraft listed as non-compliant in 1981 will be phased out in order to comply with the Congressional mandate on noise. Most of the DC-8-61s and -63s, for example, will be re-engined; many of the later versions of the B-727, B-737 and DC-9 will be modified. Many of the 1,283 aircraft are candidates to be phased out, however. It must be assumed that, in preparing to meet the noise regulations, airlines kept early 1980 aircraft sales up despite the recession and resultant drop in traffic. In many cases, the noise regulations have accelerated the normal retirement cycle of the airlines. Therefore, the combination of retirement of aircraft due to economics and the noise requirement results in an anticipated U.S. aircraft replacement market of $17 billion (1980–1990) or about $1.5 billion per year.

Fuel economy—There is a strong analogy between the autos Americans drove in the early seventies and the commercial aircraft built and flown up to that time; in neither instance was fuel efficiency a major consideration. That changed, however, with the fuel embargo of 1973 and escalating prices since that time have ushered in a new era. The current trend toward more fuel-efficient vehicles and the scrapping of older, less fuel-efficient models in the auto industry is also occurring within the airlines. Many aircraft which have not reached the end of their normal life, or which could be utilized until 1985 and still meet noise regulations, are being retired because they are not fuel efficient. Figure 25a indicates how fuel has now become the major portion of direct operating costs. Figure 25b shows the increases in fuel costs since 1973 from 12.5 to 86.5 cents a gallon. Decontrol of oil in early 1981 will further accelerate airline fuel costs in the short run with the average annual price rising to an estimated $1.04 for the year.

Capital requirements—U.S. airlines have and will continue to have large capital requirements spurred by traffic growth,

TABLE 14

NOISE COMPLIANCE STATUS OF AIRCRAFT
IN THE U.S. AIRLINES FLEET

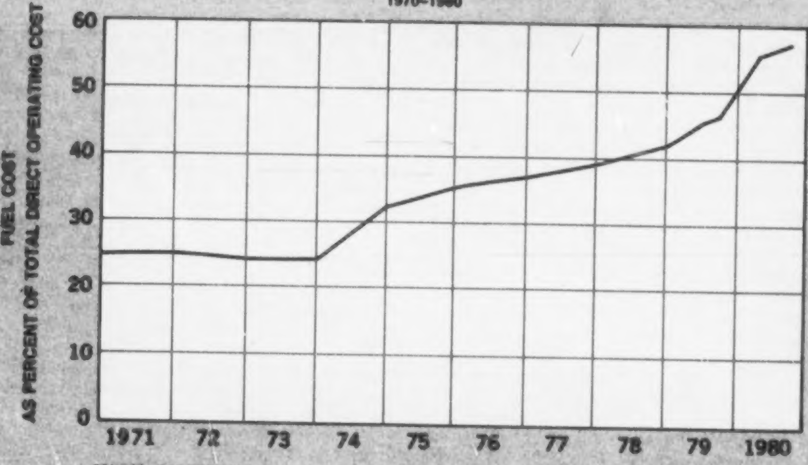
Company	Aircraft[a] Type	January 1, 1977 Compliant	January 1, 1977 Noncompliant	January 1, 1977 Percent	January 1, 1981 Compliant	January 1, 1981 Noncompliant	January 1, 1981 Percent
Boeing	B–707/720	—	298	0	—	159	0
	B–727	189	656	22.4	645	431	56.9
	B–737	7	143	4.7	79	146	35.1
	B–747	32	77	29.3	134	12	91.8
	Sub-total	228	1,174	16.3	858	748	53.4
Douglas	DC–8	—	224	0	—	161	0
	DC–9	32	335	8.7	83	316	20.8
	Sub-total	32	559	5.4	83	477	14.8
All Other	CV–880	—	25	0	—	8	0
	BAC–111	—	33	0	—	44	0
	Caravelle	—	0	0	—	6	0
	Sub-total	—	58	—	—	58	0
	GRAND TOTAL	260	1,791	11.2	941	1,283	42.3

SOURCE: Federal Aviation Administration data

a All DC–10s and L–1011s in the U.S. fleet are compliant

FIGURE 25a

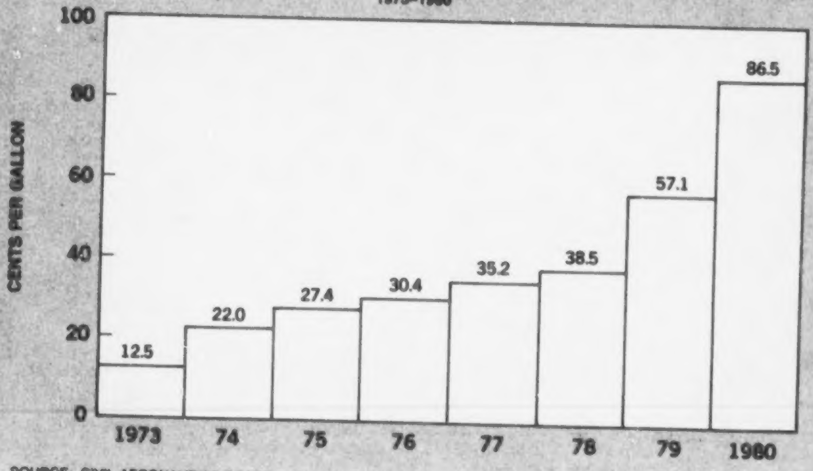
FUEL COST AS PERCENT OF DIRECT OPERATING COST
FOR U.S. TRUNK AIRLINES ON DOMESTIC SERVICE ROUTES
1970–1980



SOURCE: CAB FORM 41

FIGURE 25b

AVERAGE ANNUAL FUEL COSTS
FOR U.S. TRUNK AIRLINES ON DOMESTIC SERVICE ROUTES
1973–1980



SOURCE: CIVIL AERONAUTICS BOARD
NOTE: INTERNATIONAL PRICES VARY ABOUT 10 CENTS PER GALLON ABOVE U.S. DOMESTIC PRICES

obsolete aircraft, noise legislation and the need for more fuel-efficient aircraft. The ability to finance these capital requirements is a complex one dependent not only upon the airline but also upon the state of the financial community and the attitude of the government.

The U.S. airline industry is currently running strong deficits. In 1980, major carriers had an operating loss of $285 million and a continuing loss of $124 million during the first six months of 1981. Clearly, the industry is faced with a dilemma: the need to purchase new aircraft in the face of record-breaking losses. The industry needs to generate profits but even if this does occur in 1981, these profits will not offset the losses of 1980. Some airlines may have to go heavily into debt in order to buy new aircraft in the 1980–1990 timeframe.

The Manufacturing Industry

The manufacturing portion of the U.S. civil aeronautical industry is a multibillion dollar industry as indicated in Figure 26. Industry shipments grew from about $3.5 billion in 1970 to $13.1 billion in 1980. Even accounting for inflation, sales nearly doubled in this period.*

The civil aircraft industry is made up of three sectors with commercial transport aircraft being the major component, followed by general aviation and helicopters.

Commercial transport industry—The commercial transport industry includes three major airframe manufacturers, two engine manufacturers, and over 3,000 suppliers. The airframe industry in 1980 employed approximately 92,000 individuals including about 12,000 scientists and engineers (see Figure 27). The seventies saw employment in the aerospace industry overall drop from 1,403,000 in 1968—the industry's peak year—to a low of 894,000 in 1977; it then rose 36 percent to 1,218,000 in 1980. Preliminary figures indicate it will reach 1,229,000 for 1981.

In addition to being major employers, the three civil airframe producers also generate large sales dollars. The industry shipped $8 billion in civil aircraft in 1979, nearly

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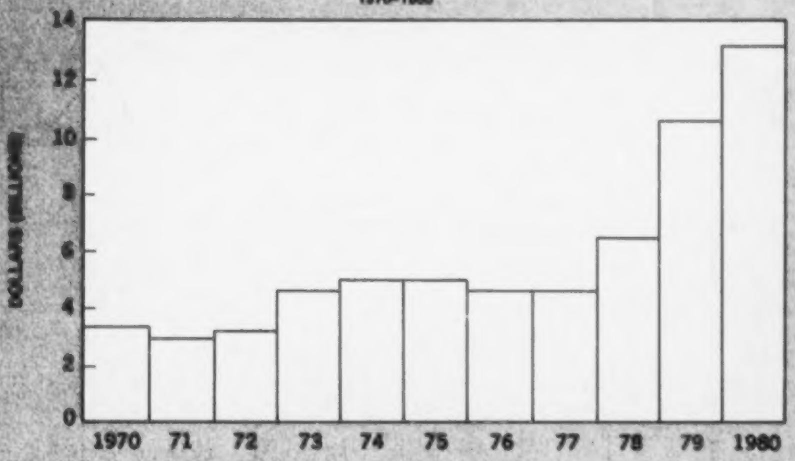
* Using the GNP Deflater, 1972 = 100; 1970 = 91.5 and 1980 = 177.4

FIGURE 26

U.S. CIVIL AIRCRAFT SHIPMENTS
1970–1980



SOURCE: AEROSPACE INDUSTRIES ASSOCIATION AND
GENERAL AVIATION MANUFACTURERS ASSOCIATION

doubling the $4.3 billion shipped in 1978. In 1980, shipments totaled nearly $10 billion. The 1970–1980 history of commercial transport shipments is shown in Figure 28. U.S. Department of Commerce data indicate that $6.7 billion of 1980 shipments were exported. Over the past five year period, the value of exports has averaged 69 percent of transport shipments from U.S. manufacturers. The dominance of the foreign market has also been pronounced in the backlog of orders, with data as of the end of 1980 showing 58 percent of the value of all unfilled orders for transports to have been placed by foreign customers. As of the end of September 1981, however, foreign orders no longer comprised over half of the backlog, having fallen to 46 percent.

General Aviation—In the seventies, general aviation manufacturers more than doubled production. While, in 1970, slightly over 7,000 units were shipped, by 1979 this figure had risen to over 17,000. In 1980, recession and high fuel costs took their toll on general aviation and shipments dropped to less than 12,000. This segment of the industry is also increasingly subject to increased competition from other countries including Brazil, Israel, France and Canada. The Embraer Bandeirante produced by Brazil, for example, is a 12–20 seat commuter in the inventory of six U.S. commuter airlines.

In 1980, general aviation shipments were $2.5 billion, up from slightly over $0.3 billion in 1970. In real terms, the industry has nearly tripled its dollar shipments in this period (Figure 29).

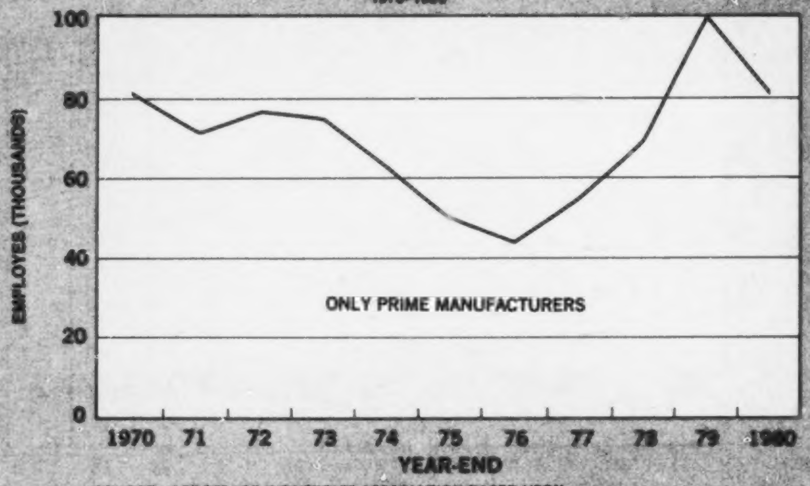
Helicopters—The civil helicopter market, while small in comparison to civil transports and general aviation, is nevertheless a significant and growing industry. The industry almost doubled the number of units shipped in the seventies. In current dollars the increase was almost tenfold (from $49 million to $403 million in 1979) indicating that, even allowing for inflation and the near doubling of units shipped, larger, more costly units were being sold. In 1980, shipments then rose to $656 million (Figure 30).

Outlook for the Aircraft Industry

With a decade of growth as a backdrop, and with shipments going over the $10 billion mark in 1980, one would assume that the industry was buoyant and optimistic. In fact, U.S. civil aircraft manufacturers are highly uncertain about the near-term future. Due to the economic downturn in the United States plus increased fuel prices, worldwide traffic

FIGURE 27

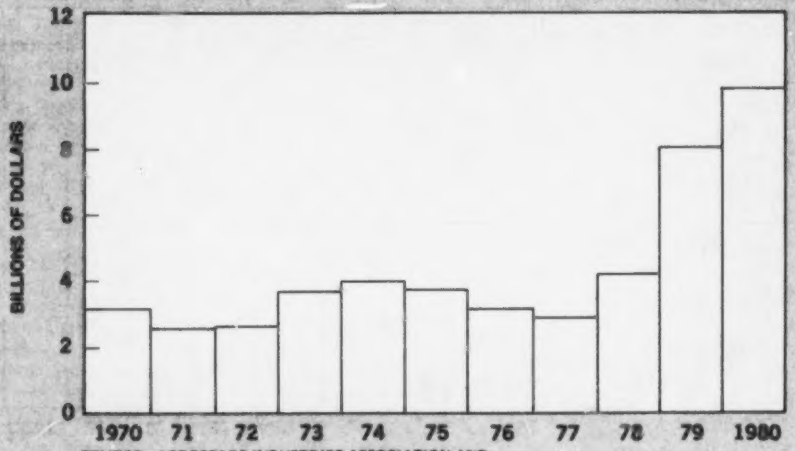
U.S. COMMERCIAL TRANSPORT AIRCRAFT MANUFACTURING EMPLOYMENT
1970–1980



SOURCE: AEROSPACE INDUSTRIES ASSOCIATION BASED UPON
U.S. DEPARTMENT OF LABOR STATISTICAL DATA

FIGURE 28

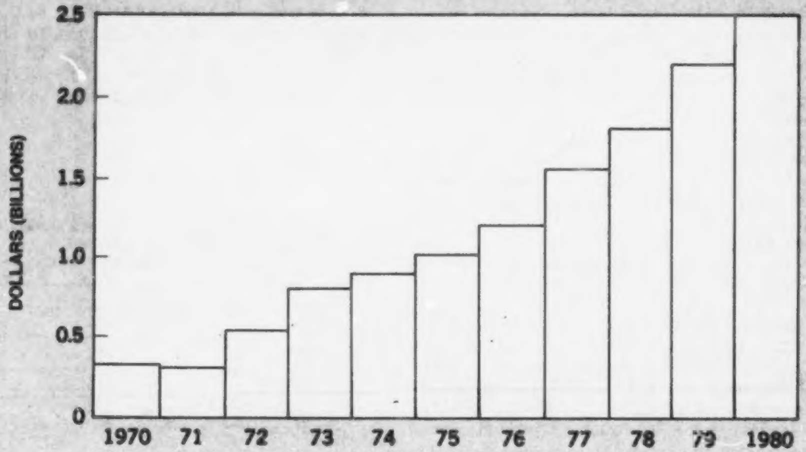
U.S. COMMERCIAL TRANSPORT AIRCRAFT SHIPMENTS
1970–1980



SOURCE: AEROSPACE INDUSTRIES ASSOCIATION AND
GENERAL AVIATION MANUFACTURERS ASSOCIATION

FIGURE 29

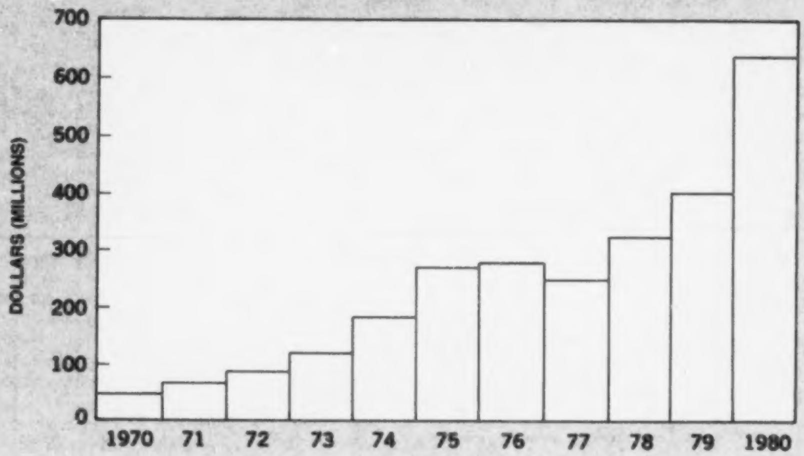
U.S. GENERAL AVIATION AIRCRAFT SHIPMENTS
1970–1980



SOURCE: AEROSPACE INDUSTRIES ASSOCIATION AND GENERAL AVIATION
MANUFACTURERS ASSOCIATION

FIGURE 30

U.S. CIVIL HELICOPTER SHIPMENTS
1970–1980



SOURCE: AEROSPACE INDUSTRIES ASSOCIATION

decline, and increased competition due to deregulation, the airlines are currently losing money, and new orders for commercial aircraft are falling off. In addition, the 1981 air traffic controllers strike stretched out existing orders, as the reduction in the number of aircraft departures lessened the airlines' need to add to their fleets. There has always been a close correlation between U.S. trunk airlines' net earnings and net orders for new aircraft. As earnings rise so do orders and, conversely, orders fall with earnings on the down-side of the cycle. Figure 14, shown earlier, presents this relationship through 1980. In 1980, airline earnings were negative, while orders remained relatively high, perhaps due to orders generated by noise regulation legislation. The 1981 air traffic controllers' strike, however, has caused a decline in traffic, with negative impact on orders for new aircraft. As Figure 14 and Table 15 indicate, U.S. wide-body aircraft manufacturers will probably suffer from overcapacity in 1982.

The aircraft industry tends to be cyclical and downturns are normally accepted as a way of life. Many of the problems the industry faces now, however, are not cyclical in nature and will continue to plague the industry. Fuel prices will continue to increase, as will route competition, but the major uncertainty in the future is foreign competition. Foreign aircraft producers present the normal threat of a rival in the competitive process, but there is also a tendency, whether by natural inclination or fiat, for potential foreign customers to buy from the home industry. Airbus, for example, has completed sales to almost every major airline in Europe: Air France, Alitalia, BCAL, Iberia, KLM, Lufthansa, SAS, Sabena and Swissair, among others. The importance of this foreign market can be seen in Table 16.

Though the extent and future threat of foreign competition are dealt with in greater detail elsewhere in this study, a brief overview is in order at this point.

TABLE 15

DELIVERY SCHEDULE OF EXISTING COMMERCIAL WIDE-BODY ORDERS AS OF DECEMBER 31, 1980

Aircraft Type	1981	1982	1983	1984	Beyond 1984
L–1011	28	13	7	—	—
DC–10	19	6	—	—	—
B–747	51	18	6	1	—
B–757	—	—	29	26	57
B–767	—	28	74	55	9
A300	43	25	10	9	4
A310	—	—	24	26	24

TABLE 16

U.S. EXPORTS OF CIVIL AIRCRAFT, ENGINES AND PARTS
1970–1980
(Billions of Dollars)

Year	Exports
1960	1.1
1970	2.5
1976	5.7
1977	5.0
1978	6.0
1979	9.8
1980	13.2
1981[e]	13.8

SOURCE: Aerospace Industries Association

Airbus and Other Competitors in the Transport Market

In 1979, the European-produced Airbus was second only to the Boeing B-747/B-767 in bookings. Airbus, in fact, had as many orders as did McDonnell Douglas and Lockheed combined (Figure 31). One should not be led to believe that the number of 1979 Airbus sign-ups was a singular phenomenon for Airbus targeted 25 percent as its share of all wide-body orders during 1980, and achieved 32 percent. Moreover, as of September 30, 1981, the consortium held 43 percent of the world wide-body backlog.

The difficulty of coping with a competitor such as Airbus is that a U.S. contractor, having first fought head-to-head with another manufacturer, then finds it is fighting head-to-head with a consortium, strongly backed by the concerned governments. In discussing a Boeing lost sale in the Middle East, for example, *The Economist* stated that "Thanks to the direct intervention of President Valery Giscard d'Estaing (and, it is rumored, a nuclear power station contract) Kuwait Airways has ordered six A310 Airbuses."[8]

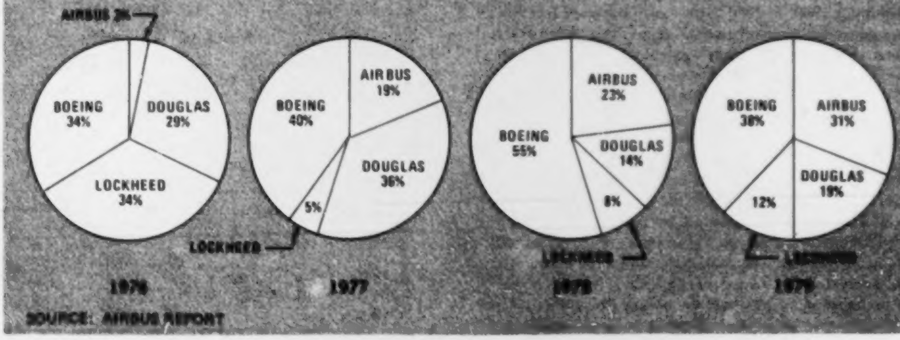
In addition to the European Airbus, the British provide some competition with a continuing low-key BAC-111 production (with licensing in Romania) plus the BAC-146, a short-range aircraft seating between 71 and 109 passengers, depending upon the model and seating density.

The Soviet Union has the technical and production capability to compete with Western manufacturers; however, lack of a worldwide marketing and support organization makes them a weak competitor at this time. Should the Soviets decide to remedy this situation in order to gain hard currency and prestige, they could perhaps become a real competitor by the end of the decade.

A distinct future competitive challenge is the Japanese aerospace industry. The Japanese have recently taken two steps that will enhance their know-how and capability. They have a significant portion of B-767 production and a team of Japanese stationed at Boeing will acquire valuable experience. They have also joined with Rolls Royce to develop a new medium-size 20,000 to 25,000 pounds thrust high-bypass engine. Japan has also proposed collaboration on the development of an approximately 150-seat airliner, among others. Should the Japanese go ahead with this project, they would be laying groundwork for a full-blown commercial airline industry. As an article in *The Economist* stated: "Ever since Pearl Harbor the Japanese have shown that they have technical skills; today they can put together even the most advanced fighter as well as anybody else. When the Japanese decide to develop an industry as a national objective, others

FIGURE 31

PERCENTAGE OF WIDE-BODY AIRCRAFT SIGNUPS OF MAJOR TRANSPORT MANUFACTURERS



SOURCE: AIRBUS REPORT

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[8] "Hard Times for America's Big Three," *The Economist*, August 30, 1980 p. 5 Survey section.

should watch out. Ask European steelmakers, West German camera manufacturers or Detroit's car giants."[3]

Foreign General Aviation and Helicopter Competition

Competition is growing in the general aviation and helicopter field. Aircraft are now available not only from Europe and the Soviet Union, but also from new sources such as Australia, Brazil, Canada, Israel, and Spain.

Imports of general aviation aircraft were $147 million in 1978, $260 million in 1979 and increased to $496 million in 1980. Helicopter imports were valued at $28 million in 1978 and $22 million in 1979 but rose to $54 million in 1980, a recession year. The overwhelming bulk of these aircraft, 85 percent, is imported from France with the remainder coming from Germany and Italy.

Sources and Levels of Government Support

The amount and depth of government support of civil aviation producers in the United States is greatly exaggerated. Several misconceptions must be clarified.

- The three airframe manufacturers have no government plant or equipment at their disposal for the production of civil aircraft.
- The fallout from military programs is now very minimal; in fact, there is a greater cross-over from civil to military technology.
- Much government R&D funding involves payback arrangements. The NASA composite materials program, for example, requires a royalty on each aircraft if the composite is utilized.

In regard to this last point, NASA Management Instruction 5109.3, "Recoupment Policy for the Use of NASA Technology," defines recoupment as ". . . a charge or fee (or royalty) imposed by NASA or by a contractor or subcontractor on the Government's behalf for the use of the technology or technological capability which was previously developed with NASA funding." An example of the application of the recoupment policy relates to the Pratt and Whitney JT8 refan engine being utilized on the McDonnell Douglas DC-9-80. The refan/acoustic work done under a NASA contract is being repaid to NASA through a fee paid on each engine delivered. Should Lockheed utilize active control technology for a small tail, recoupment would also take place.

Another source of government support which has also been vastly misconstrued is the government loan guarantee to Lockheed in 1971. The government did not lend money to Lockheed; it merely guaranteed the $400 million loan from the twenty-four banks involved. The risk to the government was minimal, as an article in *Fortune* pointed out: ". . . a risk Washington lawyers called 'de minimis'—in plain language non-existent. After all, the government held a first lien on Lockheed property valued far in excess of the guaranteed loans."[4] Far from being a free ride for Lockheed, the government realized a handsome return on its "no-risk guarantee"—a "$31 million profit through loan service fees."[5]

A major component of a foreign sale is the financing and the air transport industry has relied heavily on the U.S. Export-Import Bank. Unfortunately, Eximbank has been treated as a stepchild by the U.S. Congress, and its assistance to the industry has been falling short of that offered by other governments to their aircraft industries. A study by the Business International Corporation of export incentives said: "The U.S. Eximbank and the Foreign Credit Insurance Association (FCIA) have not kept pace with competing agencies in other countries. . . Many U.S. companies have found the stumbling blocks to be greater than the assistance offered."[6] A detailed look at export incentives available in other countries can be found in the chapter beginning on page 41.

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[3] "The Aeroplane Makers," *The Economist*, August 30, 1980, p. 1 Survey section.

[4] "How Lockheed Got Back Its Wings," *Fortune*, October 1977, New York City.

[5] "With 7-Year Nosedive Behind It, Lockheed Sees Blue Skies Ahead," *Los Angeles Times*, September 1979.

[6] Business International Corporation, *International Export Incentives: Comparison and Analysis of Ten Key Countries* (New York, New York, 1979), pp. 251–252.

THE EUROPEAN AERONAUTICAL INDUSTRY

The Airline Industry

Generally speaking, the major European airlines are owned and controlled by their governments and are, in fact, an extension of these governments. The extent of government ownership in the case of each airline is shown in Table 17. This close relationship—partial to full ownership—between governments and their airlines assures the airlines of many benefits unavailable to U.S. airlines including direct subsidies, direct government loans, loan guarantees, special tax treatment, and government-sponsored travel promotions. Alitalia, British Airways, and Lufthansa, among others, have received direct subsidies from their governments; British Airways, Iberia, KLM, Lufthansa, and Sabena have been tendered government loans; and loan guarantees, an almost universal procedure in Europe, are available to airlines such as Alitalia, British Airways, Iberia, KLM, Lufthansa, and Sabena.

Even in countries with private airlines, the government-owned or controlled airlines are dominant. For example, Air France and Air Inter, both government-controlled companies, generate the bulk of French airline traffic. Recent data indicates that Air France and Air Inter, representing the public sector, account for about 75 percent of the French airline traffic while private airlines account for the remaining 25 percent. The European airlines controlled by their governments are under pressure to purchase locally-made aircraft. The b-767 which competes with the A300, has not been selected by any major European airline; only four of these aircraft, in fact, have been sold in Europe—two to Britannia and two to Braathens of Norway. On the other hand, almost all the major European airlines have selected the A300.

TABLE 17

GOVERNMENT OWNERSHIP OF EUROPEAN AIRLINES

Airline	Country	Percent Government-Owned
Aer Lingus	Ireland	100.0
Air Portugal	Portugal	100.0
British Airways	Great Britain	100.0
Olympic Airways	Greece	100.0
SAS	Scandinavia	100.0
Iberia	Spain	98.7
Air France	France	98.3
Austrian Airlines	Austria	98.1
Sabena	Belgium	90.0
Deutsche Lufthansa	West Germany	82.2
KLM	Netherlands	78.0
Alitalia	Italy	75.5
Finnair	Finland	75.0
Swiss Air	Switzerland	23.6

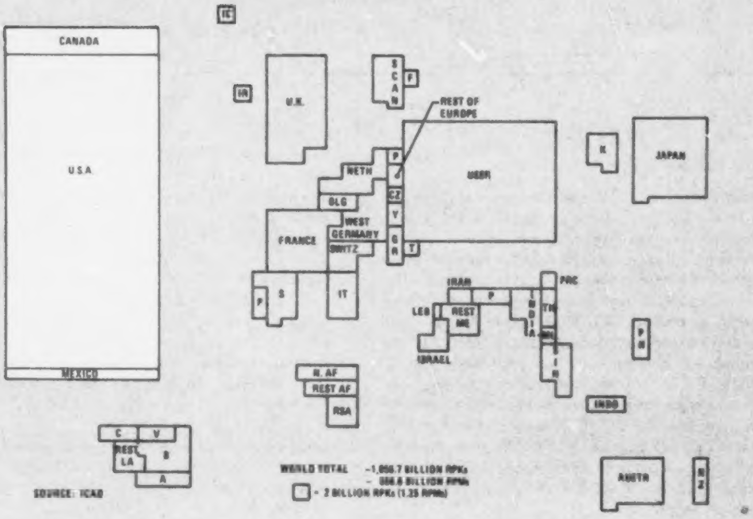
SOURCE: *Interavia*

Regional airline collaboration—A common practice among European flag carriers crossing national borders is to pool services and jointly establish schedules, equipment selection, and fares and rates. In some cases they will even pool and share revenues. An outstanding example of such collaboration is the Scandinavian consortium which formed SAS. Established shortly after World War II by the flag carriers of Denmark, Norway and Sweden, this organization collectively pooled the limited resources of these individual carriers to form a major international airline. The result is a major airline providing domestic service for member nations and carrying the flag on both scheduled and charter service around the world. Additional examples of collaboration are the ATLAS and KSSU groups. The ATLAS group consists of Alitalia, Lufthansa, Air France and Sabena, while the KSSU is composed of KLM, SAS, Swiss Air and UTA. ATLAS and KSSU were formed in the late sixties to combine the technical resources of their members in the areas of aircraft acquisition, aircraft modification, general maintenance and crew training.

Market Demand—Figure 32 has been developed in order to show the world market for scheduled airline traffic in terms of billions of revenue passenger miles served by the registered airlines of each country. If we combine all of the European segments, one can visually see that it is the second largest market in the world after the United States. Using 1979 International Civil Aviation Organization data, the world's scheduled airline traffic is broken out by nationality

FIGURE 32

WORLD SCHEDULED AIRLINE TRAFFIC
BY COUNTRY OF AIRLINE REGISTRATION
1979



SOURCE: ICAO

of carrier in Figure 33. The segments representing the United Kingdom, France and the rest of Europe, when totaled, equal 18.3 percent, making that market again second in size to that of the United States.

The intra-European market had been growing at a rapid rate; from 1970 to 1979, it grew at an average annual rate of 12 percent. This market is projected to grow at almost double the U.S. domestic market (7.5 to 8 percent versus 4.5 to 5 percent) in the 1978–1985 period.

The Europe-Mideast market will be one of the fastest growing markets for the period 1978–1985, at 10.3 percent. Even the highly competitive North Atlantic market is forecast a 4.3 percent annual growth rate for the period 1978–1985, rising to 5.2 percent for 1985–1990. Therefore, market demand for the European carriers should be strong through this entire decade.

The Manufacturing Industry

The European aerospace industry is booming. Current estimated sales are running close to $22 billion dollars, not including such countries as Spain or Switzerland. As can be seen from Table 18, the marketing success of the Airbus program plus other continuing commercial and military programs has caused rapid increases in sales—24.3 percent in 1978 and 28.9 percent in 1979. Continued growth is expected in 1980.

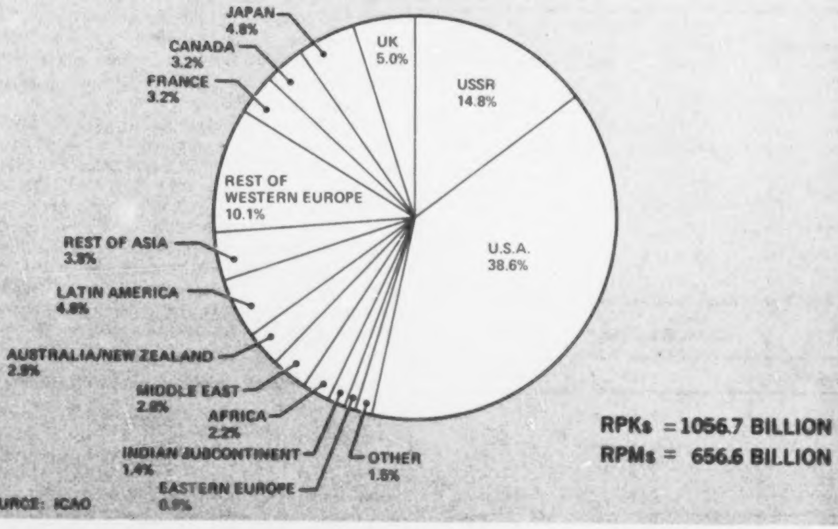
In line with the increased sales, employment in 1979 was up almost 4 percent over 1977 (Table 19). Total employment is about one half million people making aerospace a major industry. That the Europeans appreciate the value of this industry is clear: the government of Italy, for example, has declared the aircraft industry as valuable to the nation's industrial policy.

The aerospace industry also provides Europe with a valuable source of trade dollars since a good deal of its product is exported (Table 20). The European aerospace industry is fairly well subsidized by local governments. In the section that follows, specific aircraft programs are cited and attempts made to indicate the degree and level of government participation. At this point, therefore, only a few general references will be made to government subsidization.

France—Government aid to the aeronautical industry exceeded $15 billion from 1970 to 1979 or an average of $1.67 billion per year. Funding for Airbus alone will total $1.21

FIGURE 33

DISTRIBUTION OF WORLD SCHEDULED AIRLINE TRAFFIC BY NATIONALITY OF CARRIER 1979



SOURCE: ICAO

billion—almost a quarter billion dollars a year—over the next five years.

Germany—The West German Government will provide about $300 million annually through at least 1984 to support their industry's civil aviation projects.

Italy—A law was passed in 1978 to provide assistance for aerospace exports. Aeritalia is a nationalized company and military, government-funded business currently accounts for between 60 and 70 percent of total production. An example of the government's aid to Aeritalia in the commercial field is the approximately $225 million loan to help in the development of Aeritalia's portion of the B-767.

United Kingdom—The Conservative Government recently denationalized British Aerospace Ltd. but this company was heavily subsidized by previous governments on various commercial programs, particularly the Concorde. Further, the British government will have a share of between 48 and 50 percent of the new company and the firm's new relationship with the government will not endanger its participation in the Airbus program.[1] British Aerospace was expected to approach the government in 1981 for development loans to ensure its role in the A320 project.[2]

Netherlands—Fokker prides itself on being a free enterprise concern and yet the $40 million of F-28 development funds were half government funding and half government guaranteed loans.

TABLE 18

ESTIMATED EUROPEAN AEROSPACE SALES
1977–1979
(Billions of Dollars)

Country	1977	1978	1979
France	$ 5.5	$ 6.1	$ 9.4
United Kingdom	4.4	6.2	6.7
West Germany	2.6	2.7	3.5
Italy	.7	1.1	1.3
Netherlands	.3	.4	.5
Belgium	.1	.4	.4
Total	$13.6	$16.9	$21.8

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[1] British Aerospace Offer for Sale of Ordinary Shares, published on behalf of the Secretary of State for Industry, United Kingdom, 1981.

[2] "Government Before Shareholders for BAE's Airbus 320 cash?" *Flight International* Vol. 120, July 4, 1981, p. 5.

TABLE 19

ESTIMATED EUROPEAN AEROSPACE EMPLOYMENT 1977–1979

Country	1977	1978	1979
France	106,000	103,425	106,300
United Kingdom	200,000	191,000	199,200
West Germany	52,400	55,000	62,000
Italy	34,500	36,000	38,500
Netherlands	7,300	7,425	7,935
Belgium	4,900	5,070	6,600
Total	405,100	397,920	420,535

TABLE 20

ESTIMATED EUROPEAN AEROSPACE EXPORTS 1978–1979 (Billions of Dollars)

Country	1978	1979
France	$4.2	$ 6.6
United Kingdom	2.6	2.8
West Germany	1.1	1.4
Italy	.4	.5
Netherlands	.2	.3
Total	$8.5	$11.6

In summary, with both sales and employment up, the European aerospace industry is booming. In effect, the individual governments of Europe are partners with the aerospace industry and underwite not only the total military portion but a great deal, if not most, of the commercial portion of production. The various governments also actively encourage exports and, in many cases, join in the selling of aerospace manufacturers.

European Programs: Two Decades of Aircraft Production

Table 21 shows the number of European commercial transports delivered over the past 20 years. It also illustrates the capabilities of the European airframe industry to build a wide range of types of aircraft from a shorthaul, forty-passenger aircraft such as the VFW-614 to a long-range supersonic transport like the Concorde. While most of the programs—the Mercure, Comet, VC-10, Concorde and VFW-614, for example—have been distinct failures, others have been reasonably successful from a marketing standpoint. Almost 300 Caravelles were delivered over a period of fifteen years (1959–1973). Over 200 BAC-111's have been delivered and, with license production to continue in Romania, deliveries are guaranteed well into the 1990s.

U.S. manufacturers, without their government's support, could not survive short production runs such as that of the Comet, VC-10, Trident, and Mercure. Convair, for example, went out of the commercial aircraft business when the 880/990 production stopped at 102 aircraft.

It is interesting to note that at no time during the twenty-year period from 1960 to 1979 were there less than two types of European jet aircraft ready for delivery and, at one point, there were seven active programs (Figure 34).

With only 16 aircraft built and 10 delivered, the Concorde program could be assumed a failure and, from a strictly financial standpoint, it was. From a technical standpoint, however, the Concorde must be considered a resounding success, and the psychological lift it has given to the European aerospace industry is difficult to measure. Europeans long inured to second place vis-a-vis their American counterparts could now stand with pride for being first with a supersonic transport. This pride has been further augmented by the marketing and technical successes of the Airbus program.

European Programs: Objectives and Funding Sources

Airbus—The Airbus program is without a doubt the most successful program ever attempted by the Europeans. As stated earlier, Airbus had greater wide-body aircraft sales in 1979 than both Douglas Aircraft and Lockheed Corporation combined. In units, in fact, Airbus had more wide-body sales than Boeing in 1979—132 aircraft vs. 130—capturing 40 percent of the market. In 1980, Airbus again outperformed Douglas and Lockheed and captured 32 percent of wide-body orders (Figure 35).

TABLE 21

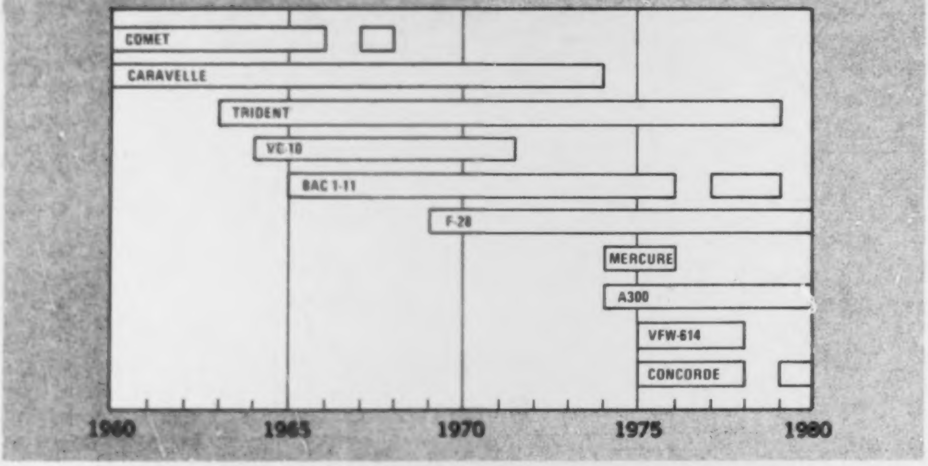
EUROPEAN JET AIRCRAFT DELIVERIES 1960–1979

Aircraft Type	Number
Comet	33
Caravelle	222
Trident	117
VC–10	54
BAC–111	224[a]
F–28	144[a]
Mercure	10
A300	81[a]
VFW–614	10
Concorde	10
Total	905

[a] Still in Production

FIGURE 34

EUROPEAN COMMERCIAL TRANSPORT DELIVERIES
1960–1980



The basic A300B2 is a twin-engine, short/medium range aircraft with about 245 seats. The A300B4 is similar to the B2 but with greater range. The A310 is a derivative of the A300B2/B4, with a 20-foot shorter fuselage and decreased seating capacity of about 210 passengers; it competes head-on with the Boeing B-767. Deliveries of the A310 will start in 1983. (See Figure 35.)

The A300 is built by a European consortium called Airbus Industrie composed of Aerospatiale of France, Deutsch Airbus (MBB and VFW-Fokker) of Germany, British Aerospace and CASA of Spain. Aerospatiale and Deutsch Airbus each have a 37.9 percent interest while British Aerospace has a 20 percent interest and CASA a 4.2 percent share. VFW and Fokker, who dissolved their partnership in 1980, are associate members of the A300 and A310 programs, while Belairbus of Belgium is an associate on the A310 program. With the exception of Fokker, all of the companies are fully or partially owned by either their federal governments and/or local state governments.

The production force for the A300/A310 is currently about 12,000 employees and, according to an Airbus official, should increase to a total of about 28,000–29,000 by 1985[3]

Both the German and French Governments have heavily funded the Airbus program. The Germans estimate they will have to invest well over 2.5 billion deutsche marks through 1985 on this program. The French have said their costs, ". . .since the beginning of the program, at the expense of the budget alone or of Aviation Civile (Civil Aviation) amount to a total of 2,574 million francs (1.03 billion U.S.)."[4] In addition, the French will provide another $1.21 billion of funding for the Airbus program through 1985.

The other major contributor to Airbus is Great Britain. In 1978 the British and the consortium reached an agreement whereby Great Britain would rejoin the program. After an initial fee of about $50 million, the British agreed to invest an additional $500 million through 1983.

As Francois Swarttouw, Chairman of Fokker, said in the July 1979 issue of *Interavia* magazine, "It's a delicate subject—Airbus. It's a successful aircraft, but it requires basic support from the German and French Governments. As you have written yourself, 10 million Deutsche marks per aircraft"

The backing of these governments gives Airbus Industrie tremendous leverage and this was most apparent in the sale to Eastern Air Lines in 1978. The terms and conditions offered Eastern were truly exceptional and would have been

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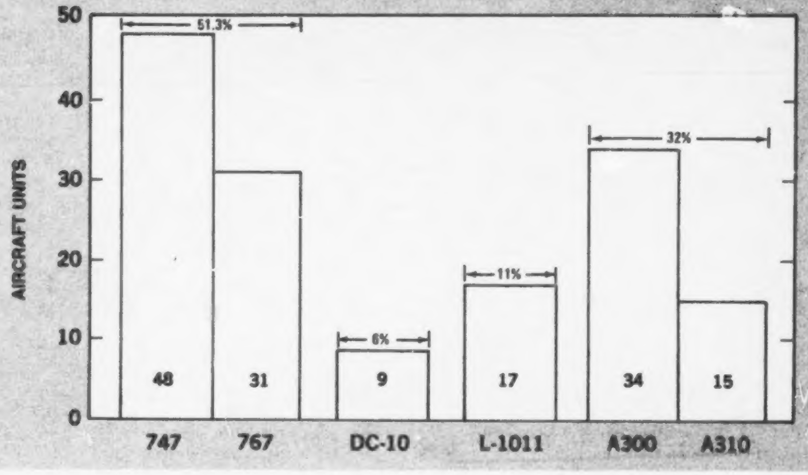
[3] "Airbus Gears for Production Increase," *Aviation Week*, November 12, 1979, p. 56.

[4] "General Report presented in the name of the Commission of Finances, Budget, Control and National Economic Accounts on the Bill of Finances for the year 1980, adopted by the National Assembly," (translated from the French).

FIGURE 35

WIDE-BODY AIRCRAFT ORDERS
1980



impossible for any U.S. manufacturer to meet. Eastern was given four aircraft to operate on a nearly cost-free trial basis. When Eastern confirmed its order, the trial lease agreement was changed to a 14.5 year lease agreement. Airbus Industrie agreed to arrange for $250 million of 10-year export credit financing through a group of European banks at 8.25 percent interest. It provided approximately $96 million of manufacturers' subordinate financing and further agreed to underwrite the operating costs of a portion of the capacity of the aircraft for at least four years (Eastern said it needed only 170 seats while the purchased aircraft would have 244). Additional inducements were offered Eastern as well. Clearly, it would have been impossible for a private enterprise U.S. aerospace manufacturer to come close to meeting these terms.

The production schedule for the A300 and A310 models calls for 33 aircraft in 1980, 43 in 1981, 55 in 1982, 72 in 1983, and 89 in 1984. One Airbus official has said that total sales should run over 1200 units.[5] To keep production levels up the consortium is looking at various derivatives. One actively being considered is the A300B9, a stretched version capable of increasing the basic B4 capacity by 20 percent. Other stretch versions would increase capacity to 25 percent. Still another with deliveries slated for late 1983 is the A300-600 which involves a grafted tail on the B2/4 allowing it to carry 10 additional passengers. The SA 2 (single aisle aircraft) can seat 162 passengers and its range is over 1800 nautical miles, or the SA 1 can seat 132 passengers with a range of 2300 nautical miles.

Fokker F28/F29—The F-28, built by Fokker of The Netherlands, is a twin turbo-fan, short/medium range transport seating from 44 to 85 passengers in the stretched version. About 150 F-28s have been delivered through 1979. Production is expected to continue at a relatively low level well into the eighties and total production approaches 250 aircraft.

MDF-100—The MDF-100 is a 150-seat, short/medium range aircraft. Fokker has been actively seeking a partner to develop and produce the MDF-100 and early in 1981 signed a memorandum of understanding to explore an agreement with McDonnell Douglas. Fokker hopes to launch this program no later than 1982, with deliveries starting in 1986. It is difficult at this time to ascertain what the possible sales for this proposed program would be.

Fokker has prided itself that its only government assistance in launching the F-28 was an initial government order for twelve aircraft, plus subsidies and government loan guarantees of $40 million. The MDF-100 program will require the Dutch Government to fund from $250 million to possibly half the total of an estimated $800 million in development costs. The Dutch Government participation, in other words, could total $400 million.

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[5] *Aviation Week*, March 3, 1980.

VFW-614—The VFW-614 was a short-range, commuter aircraft seating 40 to 44 passengers built by a consortium of German and Dutch firms with heavy government involvement. SABCA of Belgium and Short Brothers of the United Kingdom had minority interests in the project. Development of the VFW-614 was very slow causing costs to escalate. Additionally, there were few orders and production was curtailed at 10 aircraft. The involved governments reportedly lost over $125 million.

BAC-111—The BAC-111 is a short-range, twin-engine jetliner and the latest version—the -475 series—is configured for up to 80 passengers. A total of 227 BAC-111's have been sold to date. Under a license agreement with Romania, British Aerospace will deliver three complete aircraft (two passenger versions and one freighter) and transfer technology, which will lead to the first all-Romanian BAC-111, through 1985.

It is unlikely that new versions of the BAC-111 will be offered in view of other aircraft being proposed. Nevertheless, with Romanian production assured, additional orders must be anticipated and production should continue into the 1990s.

The British Government was heavily involved in the development and launching costs of the BAC-111. From 1960 to 1969, the government invested £18.75 (close to $50 million) on the BAC-111, and another nearly $25 million on the engines. Total payback on these programs was less than $9 million.[6]

Mercure—The Mercure was another multi-national project with the French in the lead with a 70 percent interest. Other members included Italy's Aeritalia and Spain's CASA with 10 percent each and SABCA of Belgium and F&W (Emmens) of Switzerland as minor partners. The Mercure is a 132/162 seat, twin-engine, short-haul transport. Only ten of the aircraft were delivered in 1974 and 1975 and the project was abandoned. The French pursued the idea of teaming with McDonnell Douglas on a joint venture to improve the Mercure and replace the DC-9, but this was abandoned after some preliminary work. The involved governments, primarily the French, invested and lost at least $150 million on this project.

Concorde—The Concorde is a technical accomplishment but a financial disaster. Not only was the production phase a tremendous burden on the British and French Governments but, in its current daily operational phase, the Concorde must continue to be subsidized.

The four-engine supersonic transport is capable of carrying 128 passengers approximately 3,000 miles, although with maximum fuel its range is somewhat greater. The program was doomed, however, by the cost of the project, the aircraft's high seat cost, restrictions prohibiting it from flying over land masses at supersonic speeds, and the ever increasing cost of fuel. A total of 12 Concordes were delivered, all to the state owned/controlled airlines of Britain (British Airways) and France (Air France). Four more Concordes remain undelivered.

The total cost of the Concorde to the British and French Governments is hard to determine. One trade publication said, "It is estimated that British Aerospace (government-owned) may lose up to $350 million on production of the Concorde not counting the $980 million invested in the development of the aircraft."[7] It must be assumed that costs to the French closely parallel those of the British. The same publication also said, "The French Government has agreed to bear the fixed cost of the aircraft, while covering 70 percent of the Concorde's operating losses".[8]

The development and production bill for the Concorde, and the losses, were staggering and the operating losses will continue for the life of the aircraft.

MBB Helicopter—Messerchmitt-Boelkow-Blohm is about one-half government-owned (city of Hamburg, Bavaria, etc). MBB developed a twin-engine light utility helicopter and has been highly successful in this project. Over 500 civil versions have been produced through 1979 and sales are expected to continue well into the eighties and total more than 1,000 units. MBB has successfully sold this helicopter around the world including mainland China. Sales to the United States have not been that large, under 100 in all, but they have penetrated that market. Sixty percent of the initial funding was in the form of a loan from the German Ministry of Economic Affairs, while additional funding was forthcoming from the German Ministry of Defense.

Aerospatiale Helicopters—Aerospatiale has been highly successful in the helicopter market. According to Rene Monory, French Economic Minister, "In the field of helicopters, SNIAS is in third place behind Bell and Sikorsky, and is exporting more than 60 percent of its production with a growing diversification into the private sector. Through its aerospace subsidiary, Helicopters Corporation in Dallas, it already has 25 percent of the American market for civil helicopters."[9] Government aid to the aeronautical industry exceeded $15 billion over the past nine years or an average $1.67 billion per year.[10]

Aerospatiale helicopters include:

- *Alouette*—A general purpose helicopter of which almost 300 copies of one version, the Lama, has sold in 24 countries and is now being produced in India under license. The SA316B has also been licensed to India, Romania, and

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[6] Neil Carmichael, Joint Parliamentary Secretary, Minister of Technology, United Kingdom, quoted in *Flight International*, February 19, 1970.

[7] "Civil Aircraft," *DMS Market Intelligence Reports*, Greenwich, Conn., 1979.

[8] Ibid.

[9] "France 1980, Economic Expansion Japanese Style," *Business Week* (Special Section), 1980.

[10] Ibid.

Switzerland. Civil production of these models should continue to the mid-1980s, with annual production currently at 40 per year, and falling to 24 per year.

- *SA321 Super Frelon*—Sikorsky helped develop this version of which over 100 have been sold in eight countries.
- *SA330 Puma*—The Puma is a medium-size transport produced in a joint program with the United Kingdom. The basic Puma has sold almost 650 copies in 43 countries.
- *SA350 Ecureuil/Astar*—A six-seat, light, general purpose helicopter, with Astar and Twin Star versions aimed at the North American market. Well over 2,000 copies of these should sell by the mid-1980s.
- *SA360C Dauphin*-This light helicopter is aimed at the offshore oil, utility and executive transport market. Close to 100 are on order, including orders from the United States. The U.S. Coast Guard has selected the Dauphin to fulfill its Short Range Recovery Mission. Sales of this version should continue through the eighties and by that time should be well over 1,000. The French Government's participation in the helicopter industry has been a long and continuing one. The government/industry relationship has resulted in French aerospace exports soaring to $6.56 billion in 1979, up nearly 57 percent from the $4.18 billion of 1978.

Military Programs

Each of the European governments is deeply involved in military programs and while complete coverage of these programs would be out of place in this report, a brief overview would include the following.

- *Mirage*—This French fighter is one of the most successful military programs ever undertaken by the Europeans. Close to 2,000 have already been ordered by 27 different countries and production was licensed in Australia, Belgium and Switzerland. Overall production will continue into at least the mid-1980s and could run to over 2,500 aircraft. A follow-on program, the Mirage 2000/4000, is already under development with deliveries slated for 1982 and this should carry the program through the eighties.
- *Panavia Tornado*—Over 20 of this fighter/bomber produced by Italy, the United Kingdom and Germany have been delivered through 1979. Over 200 are to be delivered by the mid-1980s out of a total of approximately 800 currently on order.
- *Alpha Jet*—By early 1980, 100 of this French/German light attack aircraft had been delivered with almost 500 on order.
- *Harrier*—The British produce this V/STOL tactical aircraft and produced 123 for the British government through 1979. Another 180 were produced for the United States and 13 for Spain. Production will continue through at least 1982. McDonnell has received the license for production in the United States.

The smaller European nations such as Belgium and The Netherlands are all involved in many of these military programs as suppliers or minor participants. There are also other military programs in some of these countries. For example:

- *G222*—Italy builds this general purpose transport. Through 1979, 28 were delivered with total production anticipated at 500, carrying the program through the eighties.
- *C-212*—Production of this Spanish light STOL transport is currently about 60 per year and should continue at least through the mid-1980s.

The European aerospace industry as a whole has a solid business base subsidized by government defense departments. Military programs, such as those just mentioned, help pay overhead costs for all programs, reducing the cost of commercial aircraft programs and providing possible technical fall-out from military to commercial programs.

There is a significant difference between the European airlines and aeronautical industries and their American counterparts and that is government involvement and ownership versus free enterprise. The U.S. industries, while they do not desire greater government involvement, do feel that they are at a competitive disadvantage in their day to day activities.

JAPANESE AND BRAZILIAN AERONAUTICAL INDUSTRIES

Many countries of the free world, other than the United States and the nations of Europe, are rapidly developing capabilities in the production of both civil and military aircraft. Two of the most outstanding are Brazil, which has been particularly successful in production of general aviation aircraft, and Japan. Because of their outstanding technical and commercial successes in other areas, the Japanese are seen as formidable competitors as with government support, and planning, they move to develop their aeronautical industry.

JAPAN[1]

The Airline Industry

Japan's three major airlines are Japan Air Lines (JAL), All Nippon Airways (ANA) and Toa Domestic Airlines (TDA). JAL operates domestic trunk routes only while ANA flies both trunk and local routes. TDA operates primarily local routes, though it also serves two trunk routes. Regional scheduled services are offered by Japan Asia Airlines, Nihon Kinkyori Airways and Southwest Airlines. Of the three major airlines, JAL is the only one that is half government-owned and Japan Asia Airlines, the newest of the six carriers, is a wholly-owned subsidiary of JAL. The other airlines are privately-owned.

Japan's scheduled air services have experienced remarkable growth since commercial activities were resumed in 1951 following a post-World War II prohibition. The five domestic carriers handled 33 million passengers in 1979, up almost 16 percent from the previous year. On the average, growth for 1980 is forecast in the range of 10–15 percent. The long-term annual growth is expected to be about 7–10 percent.

All of the Japanese airlines have been particularly affected by the high and increasing cost of fuel in a nation dependent on imports for 99 percent of its oil, and the airlines are attempting to reduce fuel usage and to rationalize their operations. The airlines also face problems arising from the conflict of environmental concerns and safety considerations related to inadequate facilities (both have led to operational restrictions), and the important role of the industry in support of the national economy.

Higher fuel costs and airport usage taxes led to domestic fare hikes of 23.8 percent in March of 1980. The fare increases had a negative effect on the growth of passenger traffic, and on profits. Nonetheless, in general, the airlines are enjoying strong markets with reasonable growth as, increasingly, the Japanese are travelling—and travelling overseas. More than 4 million Japanese, it is estimated, travelled internationally in 1979.

JAL expects international passenger traffic to grow 7 percent annually in the first half of the eighties and international cargo traffic to increase 11 percent annually during the same period. In 1980, All Nippon Airways, Japan's largest domestic airline, planned for business to increase by 15 percent despite the negative impact of fare increases on demand.

As Japan's aeronautical industry has not had the development capability for supersonic transports or wide-body technology, the airlines have purchased larger transports from abroad. In the early sixties, the Japanese did develop a turboprop passenger transport, however—the YS-11. Although it is no longer produced, parts are available and the YS-11 turboprops are still operating around the world. Japan's own domestic airlines, however, have been actively seeking a replacement for the 64-seat aircraft, which does not satisfy their route demands. The airlines are particularly interested in an aircraft of 100 seats or more, as quiet as the YS-11, that can serve 1,200 meter runways. Since no suitable replacement has yet been found, an equipment and parts pool may provide a temporary answer for the airlines concerned.

The Manufacturing Industry

The Japanese aircraft manufacturing industry developed in the twenties when shipbuilding companies imported European aircraft for study and purchased technology from European companies. During the thirties, the aircraft industry received support from the Japanese Army and Navy and expanded rapidly. During World War II, it produced more than 100,000 aircraft and employed, at the peak of production, more than one million people. At that time, Japanese technology was excellent and scientists and technicians were working on many highly sophisticated research and development projects. The end of the war, however, brought an end to industry activities. Only at the height of the Korean War in 1952 did the industry get underway again, doing repair work on U.S. military aircraft. Within two years, defense aviation activities were resumed and the local aircraft industry began doing repair work and then licensed production of jet aircraft and helicopters.

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[1] Source: *Japan Aviation Directory* (Tokyo: The Wing Aviation Press, Inc., June, 1980), Vol. 13.

Eventually, the Japanese resumed developing their own aircraft, the first of which was the T-1 intermediate jet trainer in the late fifties. In the non-military field, they developed the MU-2 twin-engine turboprop business aircraft in the early sixties and the FA-200 single engine light aircraft in 1967. Because development of a commercial air transport was too large a project for any single company, the domestic industry jointly produced its first passenger transport, the YS-11 turboprop—also in the early sixties. The Nihon Aeroplane Manufacturing Company (NAMC) was set up by government and industry to coordinate YS-11 production and sales. Meanwhile, the Japanese industry continued licensed production of more advanced aircraft and helicopters as well and—through this combination of repair work, license production and its own domestic projects—began to catch up with Western technology. Original Japanese technology has included flying boats, the T-2 advanced trainer later modified into the F-1 support fighter, and the Kawasaki C-1, the first domestically developed jet transport.

The Japanese aircraft engine business began by doing overhaul and repair for U.S. forces. In the fifties, a program to develop its own jet engines was begun, however, and a new firm, Japan Jet Engine, Inc., was set up by a number of companies to begin work on an engine for the Japanese Defense Agency's new intermediate jet trainer. Basic development of the J3 was completed in 1959, but Japan Jet Engine was not set up for manufacturing. Instead, most of the J3 parts were made by Mitsubishi Heavy Industries and Kawasaki Heavy Industries. Not until the sixties did the local aeroengine industry move from overhaul to production work. In the sixties, various companies also began to license-produce engines for U.S. manufacturers such as General Electric, Allison and Lycoming. In the early seventies, Ishikawajima-Harima (IHI) began manufacturing the Rolls-Royce/Turbomeca Adour engine and Mitsubishi (MHI) undertook manufacture of the Pratt & Whitney JT8D-9. The Japanese also produced about 90 percent of the parts of both engines.

Today, IHI still produces GE and Rolls-Royce engines, MHI the Pratt & Whitney JT8D-9 and Allison T63, and Kawasaki the Lycoming T53. In 1978, IHI became prime contractor for the Pratt & Whitney F100 for the F-15 program and the Allison T56 for the P-3C. KHI and MHI each have about a 15 percent share of each program.

Major Japanese firms involved in aircraft and engine production include ANA Aircraft Maintenance Company, Fuji Heavy Industries, Ishikawajima-Harima Heavy Industries, Japan Aircraft Manufacturing Company, Kawasaki Heavy Industries, Mitsubishi Heavy Industries, New Japan Aircraft Maintenance company, Nihon Aeroplane Manufacturing Company, and Shin Meiwa Industry Company. Together, however, they comprise an aeronautical industry that is substantially smaller than that of the United States or of Europe. In 1978, it employed just 25,398 persons compared to 967,000 aerospace workers in the United States and 421,176 so employed in the European Economic Community.[2] And while Japan's Gross National Product is second largest in the free world, total aerospace sales in 1978 were only about $1.2 billion. One reason is that the industry is highly dependent on military orders which, in 1979, constituted 86 percent of its business. Nonetheless, the industry has the capability for almost any aerospace product other than supersonic or wide-body transport and Japanese planners have identified the industry's future growth prospects as lying with the commercial, not the military market. The industry's particular strength currently is in design, but production technology is developing as well and the Japanese have bid successfully on subcontracts for the B-747, L-1011, and DC-10.

Future Plans—In 1979, the Aircraft and Machinery Industry Council of Japan's Ministry of International Trade and Industry (MITI) presented recommendations concerning the growth of the aircraft industry in Japan. It encouraged:

- Active support of commercial aviation aircraft and engine development projects, while continuing support of the B-767 development work in which Japan is engaged.
- Development of new aircraft to meet social and economic demands for quieter, cleaner, more fuel-efficient aircraft with improved STOL capabilities.
- Growth and technological improvement of avionics, other aircraft equipment and materials.
- Government support of the development of new civil transports including examination of the possibilities of developing a 100 seat or larger civil aircraft to replace the YS-11 by the mid-1980s.
- Government consideration and support of new aircraft technologies in the areas of: improved STOL and VTOL techniques, flying boats, hybrid lighter-than-air craft, large helicopters, ultra-light planes, takeoff and landing systems, general aviation aircraft, hydrogen-powered aircraft and private-use LTA aircraft.

The MITI advisory body stressed that the Japanese government should bear the entire risk in development of new civil aircraft technology although the ultimate business risk of the practical application of technology should be borne by industry. It also placed priority on participation in international joint development projects.

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[2] Commission of the European Communities, *The European Aerospace Industry, Trading Position and Figures* (Brussels, September 1980), p. 64.

International Cooperation

A number of recent international agreements on aeronautical projects should move Japan's aircraft industry ahead rapidly. These include the joint development of the B-767 with Boeing and Aeritalia; the license production of the Lockheed P-3C and the McDonnell Douglas F-15; and development, with Rolls-Royce, of the RJ500 turbofan engine.

The Boeing 767 project, called the YX project in Japan, is being carried out by the Civil Transport Development Corporation (CTDC) set up in March 1973. CTDC's board of directors is composed of top representatives of the domestic airline and aerospace industries and the corporation is staffed by many who worked on the YS-11 program. Japan has about 15 percent of the work on the Boeing airplane and CTDC's work is the design and manufacture of the fuselage panels and wing ribs and fairings. Japanese firms have bid successfully for subcontracts for additional work. Prime subcontractors to CTDC are Mitsubishi Heavy Industries, Kawasaki Heavy Industries, and Fuji Heavy Industries.

The prime Japanese contractor for the McDonnell Douglas F-15—of which about 90 will be totally produced in Japan in this decade for the Japanese Self-Defense Force—is Mitsubishi Heavy Industries. MHI, manufacturer of the Japanese F-1, has also license-produced the F-86F, F-104J and F-4EJ. The major F-15 subcontractor, with almost 40 percent of contract value, is Kawasaki Heavy Industries.

Over a period of 11 years, Japan's Maritime Self-Defense Force will introduce 45 Lockheed P-3C patrol planes, most of which will be license-produced in Japan under another joint agreement. Local content will increase quickly from 30 percent to about 90 percent. Kawasaki Heavy Industries is prime contractor for the P-3C, the first of which will be delivered in 1982.

For other countries, advantages of a joint development program with Japan include government support and the market advantage that a product with Japanese production involvement will have. When MITI supports an aerospace project such as the Boeing 767 or RJ500 engine development, however, it limits support to the development stage, and considers the funding a loan rather than a subsidy. For the RJ500 development, MITI decided to support 75 percent of the initial launch stage, 66 percent of the cost of producing a flight-test engine and 50 percent of the remaining development expenses if the engine goes into production. This funding represents a loan which must be repaid with interest if and when the project is profitable. Basically, the financial arrangement is the same for the Japanese involvement in the B-767 project.

Although MITI considers the ultimate commercial risk to be that of business and does not provide funds for production or marketing, unlike some of the European countries, the advantages of Japanese joint venture participation have attracted other offers from abroad for project participation. The Dutch government, for example, has asked the Japanese to participate in the MDF-100 project being undertaken by Fokker and McDonnell Douglas.

A Japanese Civil Airliner Development Program

Even working together, the five Japanese aircraft manufacturers are not as large as their overseas competition, nor able to handle development of a civil airliner on their own. Transport projects have had to be handled by special consortiums such as the Nippon Aeroplane Manufacturing Company which built the YS-11, and the Civil Transport Development Corporation which is working with Boeing on the 767. The next major civil transport project, centering on their need for a YS-11 replacement, will undoubtedly involve a similar collective effort. The envisioned YX-X program, an approximately 150-seat jetliner, has attracted possible partners including Boeing, McDonnell Douglas and Fokker. It remains to be seen what types of international arrangements will produce an aircraft for this major new transport market, but one will very likely involve the Japanese.

The domestic aerospace industry's long-term planning committee—the Society of Japanese Aerospace Companies—has stressed the importance of building Japan's independent capability for new aerospace technology, including successful development and production of new aircraft, if industry technology is to be brought up to the level of Europe and the United States. It believes Japan must first develop the 150 passenger YX-X and then a revolutionary aircraft, perhaps a high-speed turboprop or a commercial flying boat. Preliminary to doing so, however, Japan must set up the large-scale research and test facilities to do basic and applications research that it now lacks.

Aircraft Research and Development

In Japan, the Agency of Industrial Science and Technology (AIST), a division of MITI, is responsible for coordinating and upgrading the nation's industrial technology level, for promoting research and development by the private sector and government, and for planning and implementation of a comprehensive R&D policy. It promotes a National Research and Development Program, known as the "large-scale national project" system, under which government funds are directed to developing technology which would be impossible without joint effort. As of 1980, the FJR710 fanjet engine—development of which gave Japan the technology for participation in the RJ500 program—was the only national aerospace project.

The Japanese do not have a focal point for aerospace research activities, such as the National Aeronautics and Space Administration in the United States, which helps plan and coordinate R&D activities between government, industry and the universities, and which contracts for R&D programs. Instead, research is conducted through the National Aerospace Laboratory, the Research Coordination Bureau, and the National Research Institute for Metals, under the auspices of the National Science and Technology Agency (STA). Related research groups—the National Space Development Agency and Remote Sensing Technology Center—operate, indirectly, under STA auspices.

The National Aerospace Laboratory conducts a high level of research activity which focuses primarily on V/STOL technology; jet transport technology; aircraft safety, noise and pollution research; jet engine technology; and launch vehicle and satellite technology. The National Research Institute for Metals is concerned with upgrading currently used metals and developing new processing techniques.

While the FJR fanjet program has given the aircraft industry R&D facilities it did not previously have, the Japanese consider that they lack important aeronautical R&D facilities including—for engine development, for example—an altitude test chamber, a large capacity facility for testing the aerodynamic qualities of engine elements, and parts endurance and hardness test facilities. These and other essential facilities will have to be introduced carefully over the long-term, the Japanese feel, before their aeronautical technology will equal that of other nations.

General Aviation

In the general aviation field, Mitsubishi's MU-2 turboprop series has been Japan's bestselling plane; 600 had been sold as of September 1979. The same company's new MU-300 Diamond business jet began production in 1980 and early heavy sales allowed Mitsubishi to quickly sign up the first two year's worth of production, or 60 aircraft. Another entrant in the general aviation market is Fuji Heavy Industries, producer of the FA-200, of which it has sold over 300.

Helicopters

Japan has done least well in the development of helicopters. While between 900 and 1,000 have been domestically manufactured, nearly all were under license agreements with American firms or were remodeled versions of American helicopters. Japan, by itself, has not developed a helicopter except for the BK-117 utility craft currently underway. A Kawasaki helicopter project, similar to one under development by Messerschmitt-Boelkow-Blohm, has resulted in a joint development agreement between the two firms. First delivery of the BK-117 is scheduled for 1981. It is hoped that the BK-117 will capture at least 20 percent of the market based on estimates that 5,000 medium size helicopters will be sold over the next 10 years.

Exports

To date, Japan's exports have centered around the sales of their general aviation MU-2, as well as sub-contract work from other countries. Still, in 1978, exports were only 0.4 percent of total aerospace output. In the United States, on the other hand, exports were 26 percent of total sales in the same year and have increased to 30 percent of sales in 1980. Even at the peak of YS-11 transport sales, Japan's aerospace exports were only 19 percent of production.

Currently, Japan is not a threat in the world marketplace where aeronautical products are concerned. Still, it is preparing for a stronger position and its developing capabilities, and clear intent to move into the commercial market, indicate it could carve out an excellent position for itself in the future. The successful example of the Japanese in numerous other areas of technology, where they have moved ahead rapidly once a commitment has been made, adds good reason to believe Japan will become a strong participant in the community of nations with aeronautical capabilities.

BRAZIL

During the late sixties and early seventies the so-called "Brazilian Miracle" was characterized by high growth rates and accomplished by high, though manageable, inflation rates. This period of high growth was the outcome of an economic development strategy centering on export-led manufacturing growth and heavy reliance on foreign capital inflows. The Brazilian government chose the commercial aviation manufacturing sector as a field for expansion not only because of the potential for exports, but in order to reduce the larger number of aviation imports necessary in order to implement economic growth plans in a nation with such a large and underdeveloped land mass.

The worldwide oil crises of 1973 and 1979 have had a major impact on Brazil, which imported more than 85 percent of its petroleum. More recently, the Iran-Iraq war has forced Brazil to seek new sources to replace the 20 percent of Brazilian oil imports interrupted by the conflict. Brazil has been in its most critical socio-economic period in the last decade with the rate of inflation rising to a 16-year high of over 100 percent. The current account for 1980 was expected to reach $12.5 billion, up $2 billion from 1979 and Brazil's foreign debt, largest among developing countries, was to exceed $55 billion for 1980. These economic difficulties coincide with a political liberalization process now under way and with a revival of labor unionism that has produced wage settlements equal to or greater than the rate of inflation.

The momentum of the Brazilian economy at this time is such that the tough measures being taken to curb aggregate demand and thus maintain foreign borrowing at sustainable levels are likely to continue and to result in lower levels of aviation imports.

Aviation Sector

Brazil has made a greater effort than most other Latin American countries to foster the nation's own manufacturing capabilities through its procurement program. Currently the sixth largest aircraft producing nation in the world, Brazil is positioning itself for emergence as a significant economic, military and manufacturing power in the eighties. Using sophisticated European technology as its base, for example, Brazil's armament industry is not only aiming at self-sufficiency but also at a large exportable surplus. Brazil's potential has attracted arms producers from France, Belgium, West Germany, and Italy—all willing to collaborate in coproduction. This effort at self-sufficiency, and a current bias among some Brazilian procurement officials away from U.S. weapon systems, was largely the result of U.S. refusal to sell advanced weapon systems to Brazil in the mid- and late sixties. The United States suggested that Brazil instead spend its money on more immediate social and economic needs. Relations further deteriorated in the late seventies following U.S. criticism of Brazil with respect to human rights.

Over the last five years, U.S. civil aviation exports to Brazil have averaged $175 million per year with significant growth occurring in all components during 1980.[1] In the large transport sector, Brazil is no longer exclusively supplied by U.S. manufacturers—not since the introduction of the Airbus A300 at Cruzeiro in 1980. In the general aviation sector, U.S. exports to Brazil have averaged more than $16 million per year with significant growth occurring in 1979 and 1980.[2] U.S. civil aviation imports from Brazil, consisting primarily of general aviation equipment, have grown dramatically over the last five years reaching almost $25 million in 1980 and exceeding U.S. general aviation exports to Brazil for the first time.[3]

While Brazilian aviation exports to the United States and other countries have been growing, Brazil has restricted general aviation imports through high duties, taxes, import deposit schemes and import licensing red tape. Some importers can apply for and do receive exemptions from these duties and deposits. Brazil has a "Law of Similars" which applies to those imports for which locally produced goods can be substituted; the imports, as a result, are not eligible for duty reduction or exemption, foreign financing or other government incentives. "Similar" imports are not prohibited outright, however.

In the early seventies, Brazil conducted a worldwide competition to determine which general aviation manufacturer would be selected for a joint program with Brazilian industry to assemble piston engine aircraft kits in Brazil. In 1974, a comprehensive, cooperative agreement was signed with Piper Aircraft Corporation involving assembly and eventual manufacture in Brazil of several twin and single-engine aircraft. Consequently, most general aviation products are covered under the Law of Similars and are difficult to import into Brazil.

Although Brazil is not a signatory to the GATT Agreement on Trade in Civil Aircraft, the U.S. Government has held several bilateral discussions with Brazil to eliminate these trade-distorting practices. In particular, an attempt was made to gain access to the Brazilian market for assembled aircraft which were substantially different from those of Brazilian manufacture. To date, this approach has been unsuccessful. The Brazilian Government did agree to streamline its import licensing procedures; it is, however, too early to detect any improvement.

The aviation industry in Brazil is controlled by the Federal Government. Airline routes, services, and fare increases are regulated by the Air Ministry through the Department of Civil Aeronautics (DAC) in much the same way as they have been regulated in the United States by the Civil Aeronautics Board. In addition, the Air Ministry is involved in equipment selection for the airlines. The Centro Tecnico Aerospecial (CTA) organization within the Air Ministry is responsible for technical matters including training, research and development, certification, and the development of the aviation industry.

The Airline Industry

The airline industry in Brazil consists of two basic groups: the national/international carriers—Varig, Cruzeiro, VASP, and Transbrazil; and the more recently established regional carriers—TAM, Rio-Sul, Nordeste, TABA and Votec.

The performance of Brazilian airlines, as shown in Table 22, significantly improved from 1975 through 1978 and compared favorably with their performance in the early seventies. Though the growth of revenue passengers per kilometer reached 25 percent in the early seventies—more than double the expansion of the gross national product of that period—the petroleum crises of 1973 and 1975 initially resulted in fares which were higher than those of other countries with similar route structures, and in financial difficulties for the Brazilian airlines. The majority of the shares in Cruzeiro, however, were acquired by a major shareholder in Varig, one of the largest private airlines outside of the United States. While retaining separate identities and legal status, Cruzeiro and Varig have combined schedules to avoid duplication. That consolidation and the rise in productivity of

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[1] U.S. Department of Commerce

[2] Ibid.

[3] Ibid.

TABLE 22

BRAZILIAN AIRLINE TRAFFIC
1976–1980
(Millions of Revenue Passenger Kilometers)

Airline	1976	1977	1978	1979	1980
Varig	6,116	6,277	6,904	8,217	8,735
Cruzeiro	1,730	1,867	2,101	2,249	2,431
Vasp	2,040	2,215	2,674	3,108	3,217
Transbrasil	875	957	1,194	1,528	1,930

SOURCE: *Interavia* data, 1976–79
1979–80 Air Transport World, May 1981

Varig, Cruzeiro, VASP and Transbrazil contributed to the industry's recuperation. Another program which contributed to the recovery was the policy instituted by DAC to diminish fuel usage by coordinating the optimal use of equipment, and reducing flight frequency. To compensate for the loss of air service in many smaller communities the government gave subsidies for the operation of regional airlines, serviced mostly by general aviation aircraft manufactured in Brazil. TAM, Rio-Sul, Nordeste and TABA were created with stockholder participation of the four large airlines and already serve over 130 cities.

The Manufacturing Industry

Embraer (Empresa Brasileira de Aeronautica S.A.) evolved from the former Departmento de Aeronaves of the Brazilian Government in 1969 and is today the nucleus of the Brazilian aircraft industry. The company employs over 5,000 workers turning out an average—over the last several years—of 40 aircraft a month in modern facilities at Sao Jose dos Campos.[4] Embraer's sales and orders for aircraft, technical assistance and spare parts first exceeded $100 million in 1976. Reduced Brazilian economic growth due to the world energy crisis held sales in 1977 and 1978 at about the same level but by 1980, they had reached $171.3 million. Export sales which were at $38 million in 1978 had more than doubled, reaching $84.1 million, in 1980. At the end of 1980, Embraer's paid-up capital was CR 2,678.1 million ($42 million.) The Brazilian Government owns 54.5 percent of the voting shares, with 89.2 percent of subscribed capital being held by private shareholders.

Embraer produces 11 different types of aircraft in 50 separate models. These include: the EMB-110 Bandeirante; the EMB-111 maritime reconnaissance version of the Bandeirante; the pressurized EMB-121 Xingu twin-turboprop transport aircraft; the EMB-326GB Xavante license-built version of the Italian Aermacchi M.B. 326GC jet trainer and ground attack aircraft; the EMB-210A Ipanema agricultural aircraft; and various Embraer-built versions of the Piper Cherokee Pathfinder, Arrow II, Cherokee SIX, Lance, Seneca II and Navajo Chieftain, built under license. The Bandeirante is the most sophisticated Brazilian undertaking and has gained worldwide sales. It is a twin-engine turboprop with a Pratt & Whitney PT6 engine. Its great advantage is its ability to take off from a 200-yard runway. Embraer is now producing an average of four Bandeirantes per month, but this production rate could double over the next five years as a result of U.S. certification for commuter operations.

Several new programs are underway or being considered by Embraer, including: development of the EMB-120, a twin turboprop 29-passenger commuter aircraft, as a follow-on to the EMB-121 Xingu—production not expected until 1982; development of a tandem-seat, single-engine, turboprop-powered primary flight trainer; joint development, along with Aeronautica Macchi of Italy, of a new single-seat, light attack aircraft to meet the requirements of both the Italian and Brazilian Air Forces.

Other general aviation manufacturers in Brazil include Neiva and Aerotec which build military trainers and subcontract to Embraer.

Helibras (Helicopteros do Brasil, S.A.) was formed in late 1977. It is jointly owned by Aerospatiale of France and the State of Minas Gerais (45 percent) and Aerofoto, a Brazilian firm (10 percent). It has embarked on a program that will involve assembly, and in time the local manufacture, of Aerospatiale helicopters. Assembly of the Aerospatiale Lama began in 1979 and, according to Helibras' reports of recent sales in Bolivia and Chile, the 1981 production run of 18 units has already been sold. Production will be increased to 24 aircraft in 1982; thereafter, predictions are optimistic that Helibras will repeat Embraer's success in meeting domestic needs and expanding into foreign markets. U.S. and European helicopter manufacturers can expect increasing competition from Helibras—initially in the Latin American market and, eventually, elsewhere.

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[4] Embraer, *General Information, Brazilian Aeronautical Industry 1980*.

While the aeronautical establishment in Brazil is currently experiencing some difficulties, primarily due to the nation's economic problems, it is expected to grow at above-average world rates over the longer term. Airline activity at both the trunk and regional level will expand vigorously as Brazil industrializes. The aviation manufacturing sector is also expected to experience rapid growth both from meeting the country's general aviation air transport needs, and from continued diversification into new product areas such as military trainers and helicopters. The cloud on an otherwise bright future is Brazil's dependency on imported petroleum. Further shocks to the world's petroleum supply sources and distribution system could have a pronounced effect on Brazilian development and on its aviation industry.

THE SOVIET AERONAUTICAL INDUSTRY

The Airline Industry—Aeroflot

In 1973, an Aeroflot official visiting the United States described his organization as being, "in American terms, a combination of the Civil Aeronautics Board, The Federal Aviation Authority, several major airlines and general aviation operators."[1] Aeroflot is, in other words, the operator, regulator, overseer and standard setter for an industry that, domestically, includes only one airline—Aeroflot. In addition, it is the only airline in the world that warrants its own aerospace industry to support it. Figure 36 shows the relationship between Aeroflot and the Soviet aircraft design bureaus.

In addition to being the world's largest airline, Aeroflot also includes: an agricultural division; a helicopter (forest, fire) patrol; and survey, ice and fish reconnaissance, and aeromedical services. Aeroflot is also involved in hotel operations, catering, logistics, air traffic control development, as well as preparation of specifications for both aircraft and ground equipment. A few statistics in regard to these ancillary activities will indicate their vast scope.

"The agricultural aviation fleet performs some 80 percent of all spring fertilizer distribution and 40 percent of all plant protection work. The annual defoliation of the cotton crop before harvesting employs some 1,300 An-2 and a few helicopters. . . The aero-medical service made some 70,000 emergency flights in 1979, serving some 118 medical institutions in the USSR."[2]

In order to maintain these many services, Aeroflot employs about 500,000 people.

Although Aeroflot serves 90 countries in Europe, Africa, Asia and the Americas, it is predominantly a domestic airline. It serves over 3,500 points within the Soviet Union, which includes 8,650,000 square miles—an area greater than the United States, Canada and Mexico combined. The breakdown of Aeroflot passengers, domestic versus international, is shown in Figure 37a and 37b.

Being a monopoly provides Aeroflot with distinct advantages, but also with minor disadvantages. Because it is a monopoly and is as large as it is, Aeroflot has its own aerospace industry to supply its needs. The aircraft provided are very rugged, heavy, and reliable and fit in well with the terrain and climatic conditions of the Soviet Union. However, because it is not ruled by cost or the competition of other airlines, Aeroflot has tended to offer aircraft that, for the most part, are short on comfort and not very fuel efficient. With the ever-increasing cost of fuel and the demand for greater passenger appeal, these aircraft pose little threat to the aerospace industries of the non-Soviet bloc.

As a monopoly, Aeroflot has the advantage of a captive audience (or captive customers) but, again, due to lack of competition, these customers receive service within the Soviet Union that tends to be capricious, sporadic, perfunctory and, generally, a non-satisfying experience.

The Manufacturing Industry

The aerospace manufacturing industry of the Soviet Union is second to none in the world, its capabilities covering the entire spectrum of aerospace activities: space, missiles, satellites, and military and commercial aircraft.

Space Activities—Soviet exploits in space are well known, starting with Sputnik in 1957 to the recent record-breaking endurance feat of maintaining cosmonauts in space for 175 days.

Military Aircraft—In the military aviation field, Soviet achievements are no less spectacular. Their interceptor aircraft may well be the finest in the world, while their fighters and bombers rank with the best. In addition, they have the capability to produce military aircraft in large quantities. The International Institute for Strategic Studies, for example, has compiled statistics showing the strength of NATO tactical air forces versus those of the Warsaw Pact nations.[3] Even when 100 American dual-based fighters and 400 French fighters are added to the NATO forces, the communist block still holds a numerical advantage with 5,795 to 3,800 aircraft. While the NATO aircraft were built by the

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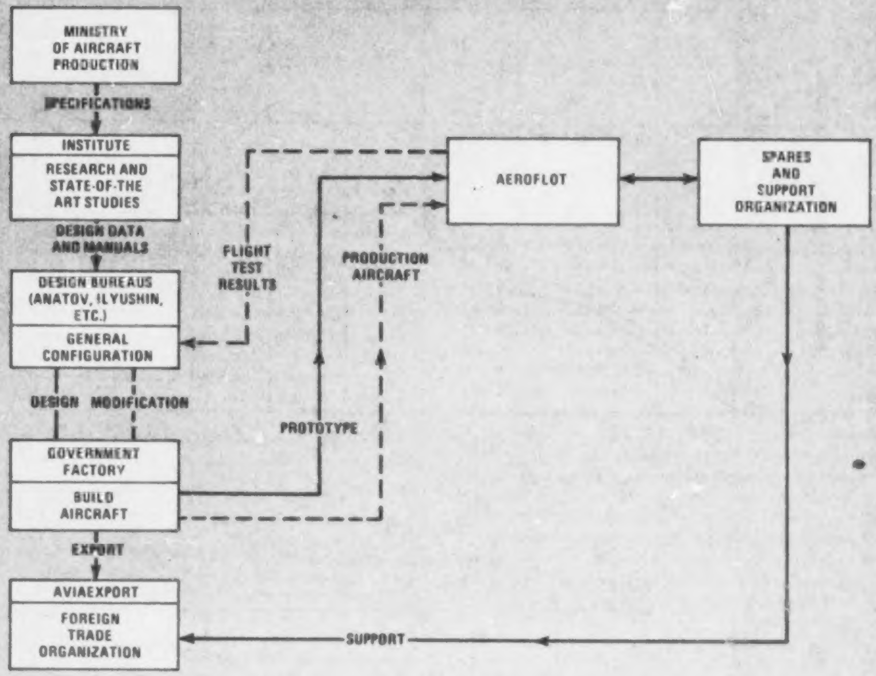
[1] "Soviet Civil Aviation Training Programs," *Interavia*, Volume 34, September 1979, p. 829.

[2] "World Airline Directory," *Flight International*, July 26, 1980, p. 260.

[3] "The Military Balance," *Aerospace International*, The International Institute For Strategic Studies, December 1979/January 1980, Vol. 15, No. 6, p. 134.

FIGURE 38

SOVIET AEROSPACE INDUSTRY ORGANIZATION


MINISTRY OF AIRCRAFT PRODUCTION
SPECIFICATIONS
INSTITUTE
RESEARCH AND STATE-OF-THE ART STUDIES
DESIGN DATA AND MANUALS
DESIGN BUREAUS (ANATOV, ILYUSHIN, ETC.)
GENERAL CONFIGURATION
DESIGN
MODIFICATION
GOVERNMENT FACTORY
BUILD AIRCRAFT
EXPORT
AVIAEXPORT
FOREIGN TRADE ORGANIZATION
FLIGHT TEST RESULTS
PRODUCTION AIRCRAFT
PROTOTYPE
AEROFLOT
SPARES AND SUPPORT ORGANIZATION
SUPPORT

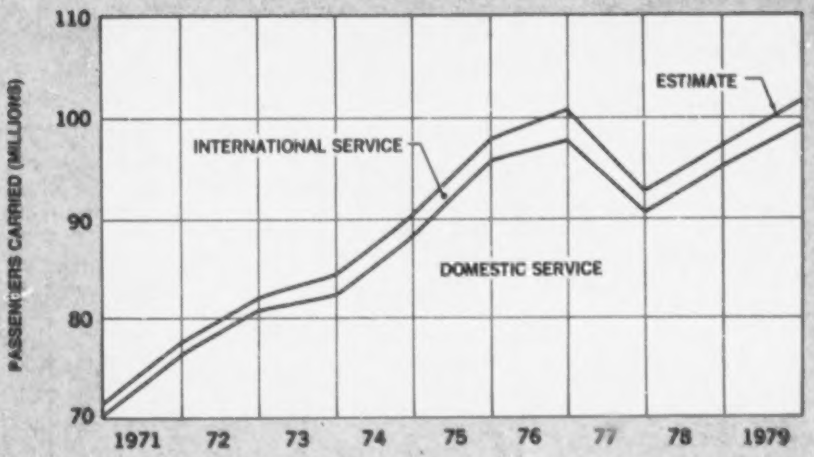
United States, France, the United Kingdom, and other European nations, the nearly 6,000 Warsaw Pact aircraft were built by the Soviet aerospace industry. Figure 38 indicates those nations that fly Soviet military aircraft excluding the Americas and, in particular, Cuba. In one sense, the map overstates the Soviet position in that China and Egypt are no longer part of the Russian sphere of influence. One must also keep in mind that many of the Soviet designed aircraft in the Indian inventory are built in India. Nevertheless, the depth of penetration of Soviet military aircraft into Africa, the Middle East, and Far East not to mention Eastern Europe and Finland (which is not shown on the map) is clear.

Mention of their space and military aircraft program is made to show not only the technical achievements of the Soviets but also their productive capability. In a totalitarian state such as the Soviet Union, an official edict can change the product mix of an industry at any given moment. If the Soviets should decide to expend greater effort in the commercial field, they would have the required manpower, plant, equipment and technological know-how to become a full-fledged competitor of the United States.

Commercial Aircraft—The Soviet aerospace industry supplies aircraft to the world's largest airline, Aeroflot, in addition to the airlines of its satellites—East Germany, Czechoslovakia, Hungary, Romania, Bulgaria, Yugoslavia, and Cuba. Other countries using Soviet commercial aircraft are Vietnam, Laos, North Korea, Afghanistan, and the Peoples Republic of China (prior to the Chinese/Russian split). YAK-40s (a Soviet short-haul transport) are also included in the inventory of West German, Italian, and French operators.

FIGURE 37a

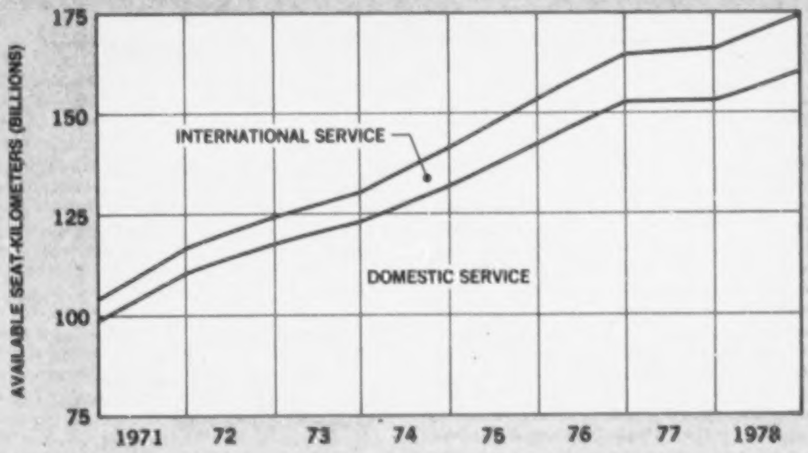
AEROFLOT AIRLINE TRAFFIC
1970–1979



SOURCE: INTERAVIA DATA

FIGURE 37b

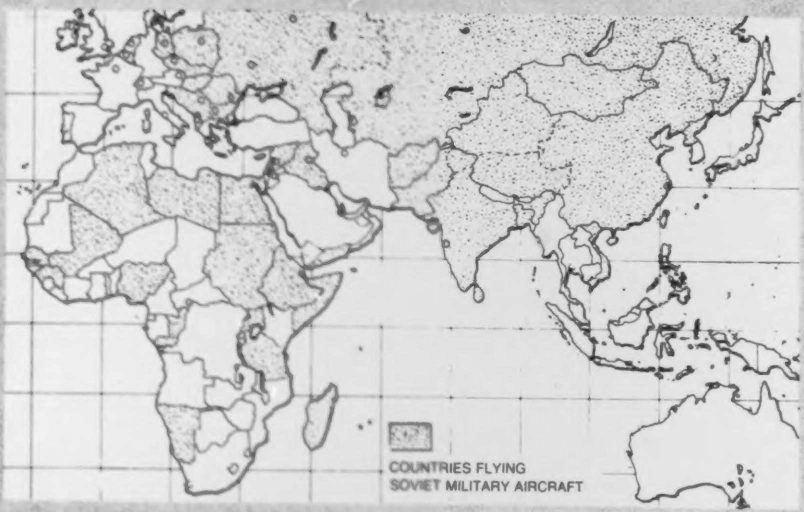
AEROFLOT AIRLINE TRAFFIC
1970–1978



SOURCE: INTERAVIA DATA

FIGURE 36

COUNTRIES OF AFRICA, EUROPE, MIDEAST AND ASIA
THAT FLY SOVIET-DESIGNED MILITARY AIRCRAFT



The Soviets build a wide array of commercial aircraft, from small taxitype aircraft to the most sophisticated modern widebody airbuses and supersonic transports. From a range/capacity standpoint, these aircraft could easily fill the needs of the average free world airline. A representative listing of current aircraft is shown in Table 23.

Industry Structure—Since the Soviet aerospace industry is totally government-owned and controlled, there are a great many bureaucratic levels which tend to create a complicated, uncoordinated, cumbersome and confusing structure. The following paragraphs illustrate the system's complexity and lack of coordination:

The Ministry of Aircraft Production submits a set of specifications to the relevant research institutions. One would assume, although it is not necessarily so, that Aeroflot has been a party to this act. These institutions do the basic research and state-of-the-art studies. They, in turn, submit design data and manuals to the Design Bureaus.

The final design of the Bureau is then sent to a government factory and a prototype is built and delivered to Aeroflot for flight testing. The flight test results are resubmitted to the Design Bureaus, which make the necessary changes in the design. A final design is submitted to the government factory and production aircraft are built and delivered. Another distinct group provides spares and support. Should the aircraft be exported or should attempts be made to export it yet another group—Aviaexport, the foreign trade organization—is brought into the process.

Figure 36 illustrates the complex relationships between these various organizations. This cumbersome structure, it must be assumed, is one restraining influence on attempts by the Soviets to increase commercial aircraft exports.

Aerospace Export Potential

The Soviet aerospace industry has a built-in active market with its East European satellites and, previously, with the

TABLE 23

SOVIET COMMERCIAL TRANSPORTS CURRENTLY IN OPERATION
(Over 85 passengers only)

Aircraft	Number of Passengers	Range (Maximum Payload) (miles)	Comments
Il–18V	84–110	1990–2300	Over 700 built (100 exported)
YAK–42	100–120	620	First flight March 1975
Il–62	122–186	4160	In service September 1967
TU–144[a]	140	4030	Supersonic Transport
TU–154	152	2050	In service 1974
Il–62M	186	4160	In service 1974
Il–86	350	—	Wide-body in service in 1981

a Currently not in regular service

mainland Chinese. Data indicate that aircraft exports increased quite rapidly from 1960 to 1965 and continued to increase significantly through mid-1970 (Table 24). It is assumed that the more recent figures include military sales; they are nevertheless, quite instructive.

TABLE 24

SOVIET AIRCRAFT EXPORTS[a]

Year	Rubles (In Millions)
1960	3.8
1965	94.1
1970	153.0
1975	303.0
1976	363.0

a Member States of the Council for Mutual Assistance, *Statistical Yearbook*

Despite these impressive export figures, the Soviet Union has not made any serious inroads in the non-Soviet-satellite world. Only the 25-30 passenger YAK-40 has been sold outside this sphere and its sales have been quite limited. The reasons for this are many and varied and it is difficult to pinpoint which is the most important. Several of these reasons are listed below.

- *Design Emphasis*—The Soviet emphasis has been based upon operating in rugged weather and remote areas. Genrikh Novozhilov, Chief Designer of Ilyushin Design Bureau, has said that, "One of the stipulations for the design (IL-86 wide-body) was that it should not involve any reconstruction of existing airports and runways."[5] Even in an age of rising fuel costs the Soviets still emphasize ruggedness and, as a consequence, pay a penalty in higher fuel costs.
- *Spares and Support*—To remain competitive, free world airlines must adhere to existing schedules, which in turn are based upon the ready availability of spares and support services. The bureaucratic organization of the Soviet aerospace industry makes its after-sales service highly questionable.
- *Maintenance and Service*—In the free world, the airlines maintain their own aircraft and aircraft are designed with this in mind. The Soviets, on the other hand, due to a shortage of trained mechanics, return products to the factory for overhaul. This places the airline at the mercy of the system, taking maintenance out of their hands and their control.
- *Other*—Since the Soviets have one major customer, Aeroflot, the product is designed for that airline. Since Aeroflot is a monopoly in Eastern Europe and Russia, its demands are for a safe reliable aircraft, not necessarily one with great customer appeal. The close working relationship that exists between a U.S. manufacturer and an airline is difficult to duplicate in a closed society such as the Soviet Union.

Detente

The cooperative World War II relationship between the United States and the Soviet Union quickly disappeared after the war. It was replaced by the Cold War and symbolized by the Iron Curtain. There have been highs and lows in the intervening years but, despite some very serious and

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[4] Member States of the Council for Mutual Assistance, *Statistical Yearbook*.

[5] Quoted in "Soviet Exports," *Interavia*, Vol. 35, May 1980, p. 426.

potentially dangerous situations such as the U-2 flights/Gary Powers incident and the Cuban Missile Crisis, the trend has been toward accommodation or *detente*. Currently, the Soviet invasion of Afghanistan and subsequent U.S. reaction have once again strained East-West relationships. It is conceivable, however, that this situation will be resolved and that the process of detente will be resumed.

It is interesting to note the reluctance of many of the United States' allies to punish the Soviets for Afghanistan. Our allies have many lucrative business arrangements with the East and do not want to jeopardize them; West Germany, as an example, is negotiating a $9 to $13 billion gas pipeline project.[6] Western Europe is heavily enmeshed economically with Eastern Europe and Russia and a complete break is almost inconceivable. Visits by the heads of state of France and Germany to Moscow indicate the depth of this relationship. While Chancellor Helmut Schmidt of West Germany, in his visit, was firm in his stand on Afghanistan, his overall stance was conciliatory.

The reluctance of many free world countries to boycott the Olympics as a symbolic condemnation of the Soviets for their actions in Afghanistan is also noteworthy. It seems to indicate that large segements of the free world, or at least those nations not aligned with the Soviets, will act independently of the United States in their relations with the Soviet Union.

The climate for a future, intensified Soviet commercial aircraft sales campaign must therefore be considered positive. Increased East-West trade and greater economic interdependence is the current trend and will continue and probably intensify. Third World countries, many of which have purchased Soviet military aircraft, will undoubtedly feel no compunction about buying Soviet commercial aircraft. *Not* buying U.S. aircraft may, in fact, be a way for a nation to flaunt its independence of the United States. The purchase of a Soviet airliner could become a badge of honor, instead of a stigma, in a political context.

Future Soviet Plans

The Soviet Union is a controlled, closed society not given to revealing its specific long-range plans—except for its politically-oriented and often unattained Five-Year Plans. Any attempt, then, to predict Soviet intentions in any area must necessarily be based upon the existing situation, changing factors that impinge upon the situation, and judgments as to whether these factors may result in a new plan, and what it will be. One indication of their interests may lie in the recent announcement of a new support and maintenance system to provide better service for foreign purchasers of their aircraft.[7] In any event, it is clear the Soviets do have the capability to design and build commercial aircraft that can compete with those of the United States and Europe. The inhibiting influences—poor fuel economy, lack of passenger appeal, lack of spares and support services—would have to be considered in an assessment of whether or not the Soviets may, or can, become a worldwide competitor.

A declining rate of petroleum production through the eighties could have a profound influence upon Russian design criteria. Previously, aircraft design decisions have been influenced by ruggedness and safety, not economy. As quoted earlier, the chief designer for Ilyushin stated that the major stipulation for the IL-86 was not fuel economy but rather existing airports and runways. However, the Deputy Minister of Civil Aviation, Yuri G. Mamsurov, writing in the Soviet air transport newspaper has said that the fuel conservation plan outlined by the Central Committee of the Communist Party and the Council of Ministers requires, "a creative search of all possibilities for economizing on fuel resources."[8][9]

The Soviets have then, the ability and capability to design and produce sophisticated, safe, modern transports in large quantities, but for various reasons, including lack of fuel efficiency, customer appeal and support services, have not been successful in selling their aircraft except in their satellite countries or to allies. The obstacles in the way of Soviet sales to the free world are not, however, insurmountable and there is a strong possibility that the Soviets must be reckoned with as competitors, perhaps as soon as the end of this decade.

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[6] "West Germans Planning Soviet Pipeline Jobs," *New York Times*, July 5, 1980.

[7] Soviets Stress Product Support," *Aviation Week and Space Technology*, June 22, 1981.

[8] "Soviets Facing Aircraft Fuel Shortage," *Aviation Week*, September 3, 1979.

[9] In 1981, the CIA revised earlier estimates and indicated that the Soviet oil reserves are more extensive than originally projected. While the production rate will decline gradually throughout the 1980s, the Soviet Union has the potential to increase production in the 1990s.

Chairman **Gibbons**. Glad to have it, sir.

First let me commend you and your industry for having done such an excellent job in the export area. I am very appreciative of the fact and very proud of the fact that I see so many American products around the world. But, like you, I begin to worry about the competition.

I agree with you that we need to bring, not only for the aircraft industry, but for all exports, this aggressive financing, unfair financing, uncompetitive financing under control. It is ridiculous—it creates problems not only in international trade, but it creates problems within our own country. I cannot see any point really in treating a foreign purchaser any better than we treat an American purchaser. But I realize that the game is a tough one; it is being fought out there. But I think we ought to make it a major American policy objective to bring that matter of export financing under control. So I agree with you thoroughly on that.

Let me ask you, what do you think about coproduction? I notice on the military side the Japanese are insisting upon F-15 coproduction. Apparently, on the civilian side, I don't know whether they insisted on coproduction, or whether we sought them out. I notice more and more of this going on around the world.

Is this desirable from the point of view of the American aircraft industry? Aren't we transferring a tremendous amount of technology, or are we?

Mr. **Harr**. We are inevitably transferring, in varying degrees, some technology. We are inevitably transferring some jobs abroad. We are inevitably transferring business from our own U.S. lower tiers of subcontractors and smaller businesses to such businesses abroad.

But the reasons we are doing it, I think, are important to note, and they are major.

For one thing, the kind of unit prices that are generally prevalent in the aircraft business, whether commercial or military, are such that a single marketplace, even the big U.S. marketplace, which is the largest, no longer justifies the investment in big, new commercial aircraft. You must deal with the world as a single marketplace.

Now, we know that, and our competitors overseas know that. They, with their great appetites over the past 15-20 years to carve into the U.S. dominance of the world marketplace, which was in both commercial and military aircraft, and with their understandable desire to maintain their own high capability and high technology industry base, have tried a number of strategies to get a bigger share of that market.

One of their strategies: You are not going to get into our country as a marketplace unless you share some of the business with our people.

Another strategy is aided by our own U.S. antitrust laws. When there is a need to put together a financial base to invest huge amounts of money in the development of new aircraft, Lockheed cannot do it with McDonnell Douglas, or vice versa, or Boeing with either one of them. Therefore, the place to get an additional base, an attractive additional base in terms of financing, is often found in an overseas joint venture of one kind or another.

Market access, financing, simple wrestling back and forth to find an equitable base for the business, is part of the reason for coproduction.

What I am saying is, even though it is something that costs us, it is not going to go away easily.

For instance, one can argue, to the labor force in a country, in a given industry: Would you rather have us produce the plane under a joint venture and have some jobs, or would you rather have us not produce the plane, which will be the case unless we have a joint venture, and have no jobs?

It is not a simple thing. I think it is going to continue, and unless there is some very radical change in U.S. antitrust laws, there are going to be more U.S.-foreign joint ventures of one kind or another, including coproduction.

Now, with coproduction, certainly in the military field, in many cases our coproducing partner will say, that we are just giving/ them the bottom end of the stick, the lowest technology part of the job to do—it is nice; they get money out of it; they get jobs out of it, but they don't get much technological advance. However, in some other areas, some other types of ventures, the cooperation is so integral that technology is transferred virtually entirely.

Chairman GIBBONS. As I look at your industry you are very labor-intensive, you are very capital-intensive, you are very technology-intensive. On the labor-intensive side, with our high labor rates, we obviously have a lot to make up for as far as competition is concerned. On high interest or high capital cost, capital is now very expensive in the United States. On the technology-intensive side, a lot of it is Government-based technology. I am not sure what all of this means. And so while I am very thankful for the niche or the, I should say, the large niche that the American aircraft industry has carved for itself in the world, I am not complacent about us being able to maintain that.

How did the Airbus industry get a jump on us? I have talked to pilots who tell me that is the best commercial aircraft they have flown.

Mr. HARR. It is a very fine aircraft. But I would demur that it is the best.

Chairman GIBBONS. I would aver too, but the fellow knew more about flying airplanes than I do.

Mr. HARR. It represented the first time that they have come up with a competitive product to our high-technology aircraft products. One of the reasons is that a lot of hard work went into it. We have no monopoly on brains. The technological skills of our European and Japanese cousins are not to be underestimated. They finally got together on a three- or four-country basis and pooled their resources, which gave them for the first time the kind of financial base that we had developed in our own research and development. That is an interesting point, because the fact is that we are going to see more of that—more of the use of this new-found vehicle; namely, the Airbus Industries—consortium type operation as a base for further aircraft of competitive quality. Of course, 36 percent of the Airbus is U.S. content, engines and avionics.

Chairman GIBBONS. Yes. Let me ask you this. On the financing standstill agreement we have now in aircraft, it applies to subsidized interest rates in all regards as I understand it except to subsidized interest rates to American airlines; is that right?

Mr. Harr. Well, there have been two developments, the standstill agreement and a subsequent agreement last summer between the United States, United Kingdom, France, and Germany, which added another ramification to it. In that context all four countries' airlines are excluded from the agreement. It applies to these four countries only.

Chairman Gibbons. If we exclude all of those there is not much market left to apply it to.

Mr. Harr. There is a tremendous market left.

Chairman Gibbons. Tell me about the Brazilians.

Mr. Harr. They are coming on strong.

Chairman Gibbons. Are they not excluding our aircraft?

Mr. Harr. Yes. They are making a very determined run at the commuter-size aircraft and down. They have got a couple of good airplanes. As a matter of fact, you have probably flown on it a few times, whether you know it or not. One or the other of the Bandeirante models, an 18-passenger commuter airplane, and you will be flying a new model, the Brasilia which is coming out with larger seating capacity.

Chairman Gibbons. Is the aircraft industry doing anything to try to back the Brazilians down on excluding our aircraft?

Mr. Harr. We are working hard to try to do that, including my sitting here and talking to you now and addressing the question. They are very hard line on it. They are not signatories to the civil aircraft agreement. If they were, they would not be able to exclude our aircraft. We are very concerned about the current practice and are pressing the administration and others to talk them into joining the civil aircraft group and abiding by those rules or suffering some kind of penalty.

Chairman Gibbons. Thank you, sir.

Mr. Bailey.

Mr. Bailey. Thank you, Mr. Chairman.

These finance packages, export subsidy via finance package, that you were talking about, I have been interested in this mechanism since I first got down here about 3 years ago. This may not be a fair question, but could you perhaps do research on it and get me some figures if you cannot answer off the top of your head? What kind of persons are we talking about? I bumped into a situation with Japan where there was a finance cost package of supposedly 2½ percent. That was on a power project for turbines. I bumped into this situation with the nuclear industry. Do you have any idea, do you know off the top of your head, what the costs of some of these packages are with your industry and how they have affected your——

Mr. Harr. I would rather come back to you with the research, figures and numbers. Not only are the percentages in some cases incredible, but they also do not tell the whole story about the subsidization of a product. That is the problem the United States faces. It is very, very difficult to prove or determine, but it can be lethal in terms of competition. I am not talking just about financing. I am talking about subsidies coming before that which preclude any attempt to achieve fair prices based on the element of the development cost that has been provided by government subsidy. But when you get beyond that, you get into the actual product and price and you get into finance packages which have incredibly low and attractive interest rates, and it becomes very difficult for those kinds of commodities such as ours, and nuclear reactors, to compete.

Mr. BAILEY. Would you try to do research and provide for me some examples of those finance costs if you can find them out? We have gotten that information from other situations and the difference has been rather remarkable. We are talking about development and that kind of thing.

[The following was subsequently received:]

Because of the methods that other nations use in reporting their research allocations, we have developed a comparison using these nations' method of reporting. The first major difference between the NASA aeronautics budget and other nations' allocations is that the other nations report only those funds which are for civil aircraft application. Therefore, in the comparison that follows, those NASA aeronautics funds which have been used for military application research have been subtracted from the NASA budget. Also the table is displayed in European Units of Accounting (EUA). One EUA=$1 U.S. in 1969. A comparison of the NASA civil aeronautics research budget with the civil aviation manufacturing countries in the European Economic Community (EEC) is shown in Table 1. A second major point that should be noted and that involves accounting for R&D funds is the involvement of European nations in the funding of production of civil aircraft. As can be seen in Table 1, as the A-300 program entered a full-scale production period during the mid-1970's, those funds allocated to R&D accounts decreased. Now, as derivatives of the A-300 are being developed and other programs are being investigated, the R&D funds are growing again. However, funds allocated for the production of aircraft also include research and technology funding but are not accounted for in Table 1. The French government recently reported that it had allocated 10.8 billion francs ($2.69 billion) through mid-1980 for the development and production of the Concorde. Since this was an equal share program with Great Britain the total program is $5.4 billion. A German government report states that DM 2,000 million ($1.1 billion) had been allocated by Germany for its share (37.9%) of the development of the A-300. Since the A-300 uses General Electric engines, little of these funds was required for the development of the engines. The German government has estimated that its share of the development of the 310 derivative of the A-300 will be 3,700 million DM ($2.1 billion).

The European governments also allocate funds for the production of helicopters, commuter aircraft and general aviation type aircraft which include research and technology development funds that are not displayed in Table 1.

If the funds used for research and technology development but classified as development funds by the EEC members were added to those in Table 1, it is believed that the total would have shown an increase for each year during the 1970's time period. Historical data on R&D funds allocated for civil aircraft development by the Japanese government are not readily available. However, the Japanese government has stated that it will allocate $86.2 million to civil aeronautics R&D in 1981 which is a 20 percent increase over the 1980 budget.

Insofar as the financing of the finished aircraft or aircraft parts abroad goes, we in the United States are faced with a two-fold problem in meeting the competition. At the moment, the major problem is that our government, in the form of the Export-Import Bank, is not living up to the agreed-upon uniform financing conditions worked out between France, the United Kingdom, Germany and the United States—so we are not even reaping the rewards of that arrangement.

Second, it is still true that the backing of their governments gives some foreign aircraft manufacturers tremendous leverage. This was apparent in the sale of the Airbus to Eastern Air Lines in 1978.

The terms and conditions offered Eastern were truly exceptional and would have been impossible for any U.S. manufacturer to meet. Eastern was given four aircraft to operate on a nearly cost-free trial basis. When Eastern confirmed its order, the trial lease arrangement was changed to a 14.5 year lease agreement. Airbus Industrie agreed to arrange for $250 million of 10-year export credit financing through a group of European banks at 8.25 percent interest. It provided approximately $96 million of manufacturers' subordinate financing and further agreed to underwrite the operating costs of a portion of the capacity of the aircraft for at least four years (Eastern said it needed only 170 seats while the purchased aircraft would have 244). Additional inducements were offered Eastern as well. Clearly, it would have been impossible for a private enterprise U.S. aerospace manufacturer to come close to meeting these terms.

TABLE 1.—COMPARISON OF GOVERNMENT FUNDED CIVIL AERONAUTICS R. & D.

[Millions of EUA [1]]

	Real year EUA								
	1970	1971	1972	1973	1974	1975	1976	1977	1978
France	180	179	254		190	152	141	139	139
Germany	41	52	60		55	66	63	64	87
Great Britain	180	228	180		137	175	112	54	51
Netherlands	NA	NA	26		8	6	10	12	5
Italy	NA	NA			4	16		1	
Belgium	NA	2	3		1	2			
Total EEC [2]	410	461	523	NA	305	417	326	270	282
NASA	147	160	168		208	179	212	258	284

[1] European unit of accounting (EUA) 1969: 1, EUA=$1 U.S.; 1979: 1, EUA=$1.37 United States.

[2] Denmark and Ireland have not allocated funds for civil aeronautics R. & D.

AIRCRAFT FINANCING: THE INTERNATIONAL EQUIPMENT TRUST

A Proposal

AEROSPACE INDUSTRIES ASSOCIATION OF AMERICA, INC.
1725 De Sales Street, N.W., Washington, D.C. 20036

October 1981

THE NEED FOR A NEW APPROACH TO AIRCRAFT FINANCING

The Impact of Export Credit Subsidies

The resolution of questions concerning officially subsidized export financing for aircraft is vital to airlines, the commercial aircraft manufacturers and their governments.

The open market for new jet transports in the 1980s has been estimated at some $120 billion. About 60% of the sales made by U.S. manufacturers will be in the export market. An even larger portion of total sales made by European manufacturers will be exports from their home countries.

The current and planned expansion of product lines of major aircraft manufacturers and the increasing development of international production consortiums have created, or are about to create, direct international competition for nearly all models of U.S.- and European-manufactured commercial jet aircraft.

The operating performances of directly competitive aircraft types are very close. A small difference in operating cost can be more than offset by attractive financing. As a result, substantial, officially supported export credits at below market rates can cause airlines to purchase the most easily financed aircraft and not the most suitable. For example, a 1% difference in interest rates can mean a 4% difference in before-tax income over 10 years; subsidies offered by some governments have been far more than 1% below market rates.

The Standstill Agreement

Officially sponsored aircraft export credit subsidies are governed by the Standstill Agreement.

The Standstill was designed to avert an export credit war among the major commercial aircraft exporting countries by insuring no one offers terms more favorable than those agreed upon.

Through the Standstill, the major commercial aircraft exporting countries agreed that officially supported export credits for aircraft would not be offered with repayment terms longer than 10 years and would not cover more than 90% of the equipment price. Although the Standstill is silent on interest rates, recent typical transactions under the Standstill have been financed at rates around 9.5%.

A proposed interim agreement would require interest rates no lower than 12% for dollar denominated loans. In addition, it would limit direct loan coverage to 42.5% of aircraft price for Eximbank loans, 62.5% for European credits. (This difference is necessary to achieve parity due to the different repayment schedules used by the U.S. and European export credit agencies.) Official participation in credits in excess of these percentages would be limited to guarantees. Repayment terms would remain at 10 years. However, the interim agreement calls upon the Europeans to seriously consider a U.S. proposal to extend the term to 15 years while simultaneously eliminating interest rate subsidies.

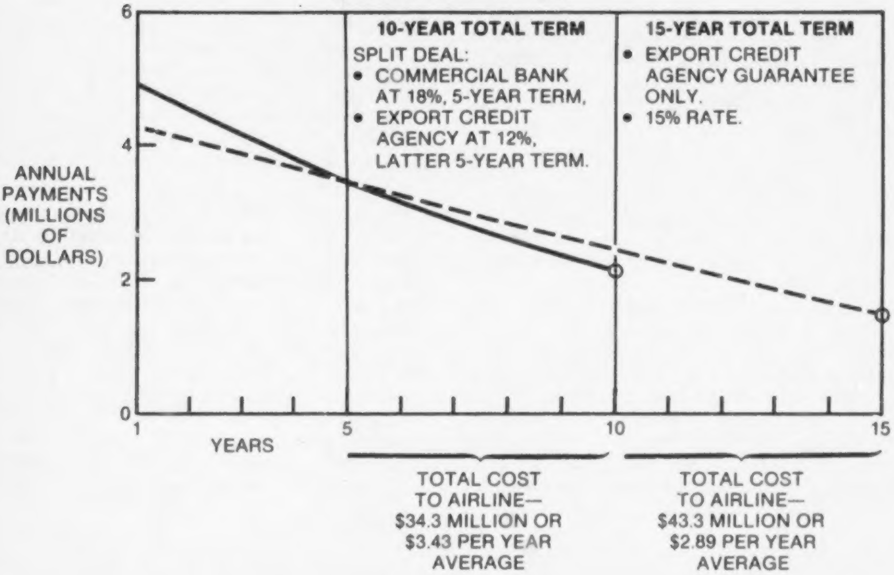
Problems Unresolved by the Standstill

The Standstill has not as yet resolved one central problem: it does not permit the term of officially supported export credits to exceed 10 years (12 years for leases) while jet aircraft useful life exceeds 15 years. This requirement of maturities shorter than aircraft useful life creates dislocations between an airline's debt service and the cash-generating characteristics of jet aircraft. The proposed agreement would solve this problem by permitting loan repayment terms of up to 15 years.

The long-term capital market has been prepared to offer aircraft financing to qualified airlines with repayment terms matched to the useful life of the asset. This long-term money is available at market rates in excess of officially subsidized rates. However, given continually high market rates, service of long-term debt is more manageable and is more realistically related to the asset's ability to produce revenue. **Longer term at private market rates is the tradeoff for subsidized export financing restricted to a 10-year maximum term (Figure 1).**

FIGURE 1

TWO FINANCING ALTERNATIVES
($20 Million Package)



While the Standstill Agreement has to a certain extent limited the further spread of subsidized export financing, it has nevertheless sanctioned the widespread use of such subsidies. It has contributed to an environment in which national treasuries compete with each other in the transfer of their nations' wealth to the customers of their respective manufacturers.

As competition increases among the European manufacturers, the U.S. manufacturers and the emerging international production consortiums, pressure increases upon the treasuries of their respective countries to reduce subsidies. Avoidance of direct subsidized funding of exports to qualified airlines would eliminate those subsidy costs to the taxpayers. Depending upon private market perceptions, these public resources might be dedicated more effectively to the aviation needs of developing nations, where air transportation is vital to economic development.

Widespread subsidized export financing and the 10-year limitation on term have discouraged development of innovative alternatives based upon the full use of the long-term capital markets which can match maturities to the useful life of the asset.

The Role of Private Capital

To maintain a free and fair competitive environment, government-supported financing should be a neutral element in the equipment selection process.

This long-term objective can largely be met by developing worldwide financing through private capital markets at market interest rates for loan terms commensurate with the useful lives of the assets.

THE INTERNATIONAL EQUIPMENT TRUST

A Generic Concept

The International Equipment Trust (IET) is a proposal designed to aid in achieving this long-term goal. It is derived directly from practical financing tools developed in the U.S. and European capital markets.

The IET would help replace officially supported export credits with private capital through a program that supplants direct credits with guarantees of private capital loans. In appropriate cases, guarantees would be replaced by asset security combined with government-issued political risk insurance.

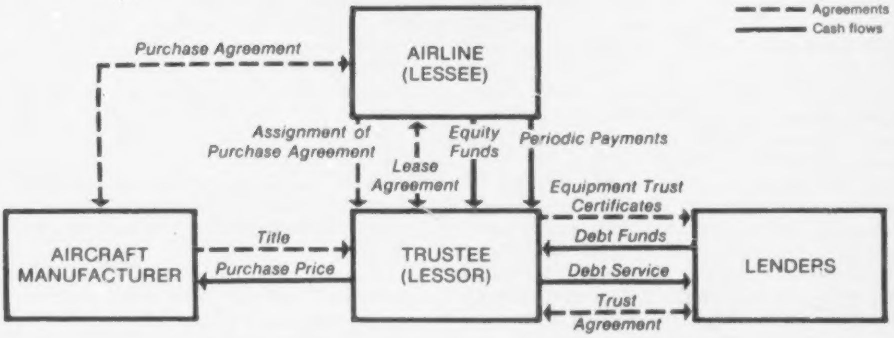
The International Equipment Trust would encompass a range of financing mechanisms, of which the equipment trust is, at least in the United States, a highly developed and flexible format particularly well suited for this financing concept. However, an equipment trust format is not required. The principle behind the IET is flexible enough to permit adaptation to the needs of a specific transaction and the requirements of local law.

In one form, the IET would work much like an ordinary equipment trust. A trustee sells equipment trust certificates to financial institutions and uses the proceeds to purchase the equipment to be financed. The trustee then leases the equipment to the airline, whose periodic payments are sufficient to pay principal, interest, and fees. Through a trust agreement, the lenders are secured by their beneficial interest in the asset owned by the trustee (Figure 2).

The equipment trust format need not be imposed upon legal systems to which it would be alien. Other legal concepts might be used to permit the desired result—beneficial ownership of the asset by numerous lenders who act through a single party. The financial transaction might involve, in place of a trustee, the use of an agent, a manager, a partnership, or other arrangements more convenient or with perhaps favorable tax consequences under the law that applies to the transaction. In what follows, "IET" and "equipment trust" are used as generic terms and refer to all types of arrangements that produce the desired result, regardless of form.

FIGURE 2

EQUIPMENT TRUST FINANCING
Generic Concept



Agreements
Cash flows
Purchase Agreement
AIRLINE (LESSEE)
Assignment of Purchase Agreement
Lease Agreement
Equity Funds
Periodic Payments
Equipment Trust Certificates
AIRCRAFT MANUFACTURER
Title
Purchase Price
TRUSTEE (LESSOR)
Debt Funds
Debt Service
Trust Agreement
LENDERS

ROLE OF THE TRUSTEE (OR AGENT, ETC.)

The central feature of the IET is the role of the trustee (or agent, manager, etc. depending upon the particular format chosen). This party gives the IET its flexibility.

First, the trustee permits the borrower to combine loans from many sources into one package governed by one consistent set of instruments.

Second, the fiduciary relationship of the trustee, agent, etc. to the lenders allows institutional lenders to leave the loan administration to the trustee, but is flexible enough to allow bank or other shorter term lenders to take an active part in administration should they wish to do so.

Third, under certain circumstances the trust arrangement may permit the tax benefits allowed beneficial owners in the applicable jurisdiction to be flowed through to airlines who could not otherwise enjoy them.

Finally and most importantly, the trustee or agent holds the security and thus allows multiple lenders to be equally secured through beneficial ownership of the asset being financed.

The Use of Government Guarantees

In the initial stages of its development, the most important difference between the IET and traditional equipment trusts is the IET's use of the full faith and credit guarantee of the exporter's government (Figure 3).

The guarantee might run (a) directly from the export credit agency to the trustee for the benefit of all, or only some, of the lenders. Or, the guarantee might run (b) directly to the lenders.

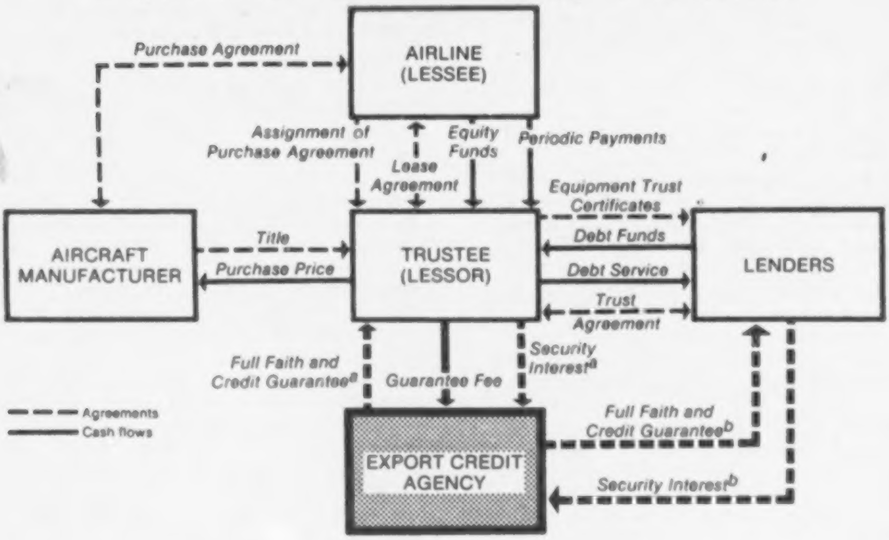
Although lenders may not insist upon security in addition to a full faith and credit guarantee, all parties will benefit if the export credit agencies build equipment trusts, or their equivalents, into their guarantee programs. This will make possible the development of the IET's later stages.

The export credit agency guarantee is important because it will play a key role in opening access to the institutional market.

U.S. institutional lenders such as insurance companies and pension funds are typically either limited or prohibited from making foreign loans. In the U.S. market, an Eximbank guarantee of the debt of a foreign airline generally converts the loan to a domestic risk, indeed, a high quality risk. However, in the format currently in general use by Eximbank, such a guarantee leaves significant problems unsolved. Eximbank guarantees are usually not assignable by their terms without the express consent of Eximbank. On the other hand, most U.S. fiduciaries are required by law to invest in instruments that can be liquidated. Thus, while Eximbank can domesticate an investment for the purposes of a long-term institutional lender, the terms of the domestication may not be acceptable without substantially revising the existing form of the Eximbank guarantee.

FIGURE 3

INTERNATIONAL EQUIPMENT TRUST FINANCING
Using Full Faith and Credit Guarantee of Exporter's Government


Purchase Agreement
AIRLINE (LESSEE)
Assignment of Purchase Agreement
Lease Agreement
Equity Funds
Periodic Payments
Equipment Trust Certificates
AIRCRAFT MANUFACTURER
Title
Purchase Price
TRUSTEE (LESSOR)
Debt Funds
Debt Service
Trust Agreement
LENDERS
Full Faith and Credit Guarantee[a]
Guarantee Fee
Security Interest[a]
Full Faith and Credit Guarantee[b]
Security Interest[b]
EXPORT CREDIT AGENCY
Agreements
Cash flows

The Need for Parity

However, even if Eximbank could domesticate foreign loans on acceptable terms, additional problems would remain. One of the chief purposes of the IET is to provide to the customers of all aircraft manufacturers equal access to the private long-term market. Since this market is at present centered in the U.S. (although Euro-money is available), the rules governing IET financing must permit loans to European manufacturers' customers on terms equal to customers of Boeing, McDonnell Douglas, and Lockheed. This requirement is dictated by basic fairness and the Europeans would never accept less.

Commercial Bank Letter of Credit To Domesticate Foreign Guarantees and To Solve the Parity Issue

U.S. Commercial Bank Letters of Credit can be used to domesticate guarantees given by European export credit agencies.

A guarantee issued by ECGD, HERMES, or COFACE does not domesticate a foreign credit for the purposes of a U.S. financial institution. Nevertheless, such credits can be domesticated through a U.S. commercial bank's standby letter of credit. The letter of credit runs to the equipment trustee for the benefit of the holders of the equipment trust certificates. These institutional lenders can look to the credit of the U.S. commercial bank and not to the credit of the foreign airline or foreign export credit agency. The commercial bank, which is not as restricted in extending foreign credits as an institutional lender with fiduciary responsibilities, looks to the export credit agency for repayment in the event payment is required under the letter of credit (Figure 4).

Letters of Credit should be used for Exim guarantees to achieve parity and to alleviate the guarantee problem.

The same arrangement can be used when the loan is domesticated by an Exim guarantee. The letter of credit can bridge the gap between the terms required by a fiduciary lender and those offered in the present Exim guarantee. A letter of credit in domestically guaranteed transactions could erase the small advantage gained by U.S. exporters' customers by avoiding the letter of credit fee. Other techniques could easily be developed to neutralize this difference to the satisfaction of all parties.

FIGURE 4

INTERNATIONAL EQUIPMENT TRUST FINANCING
U.S. Commercial Bank Letter of Credit Backed by Export Credit Agency Guarantee

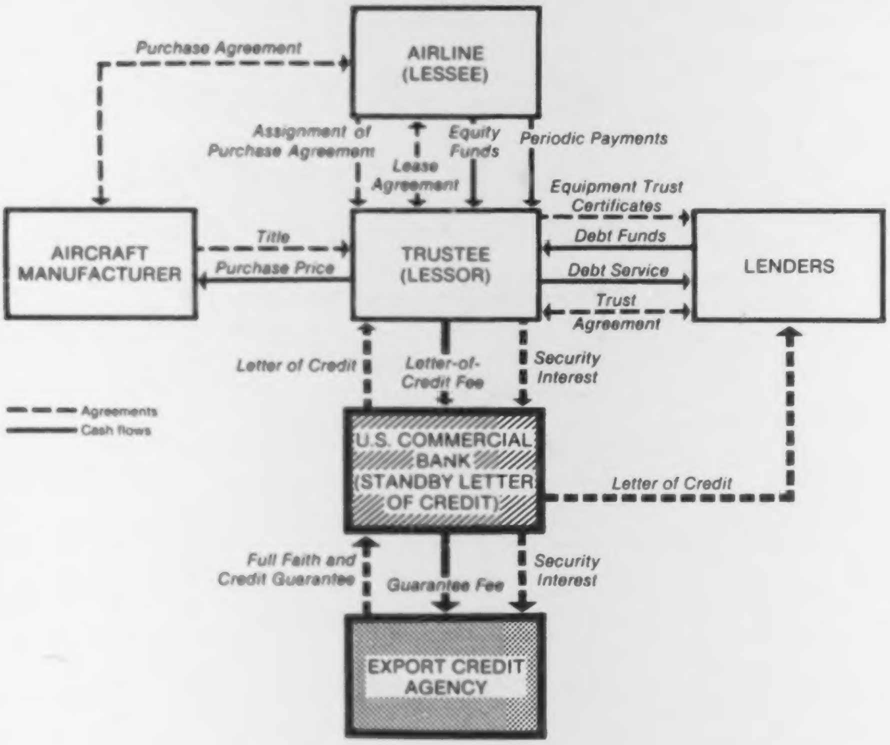
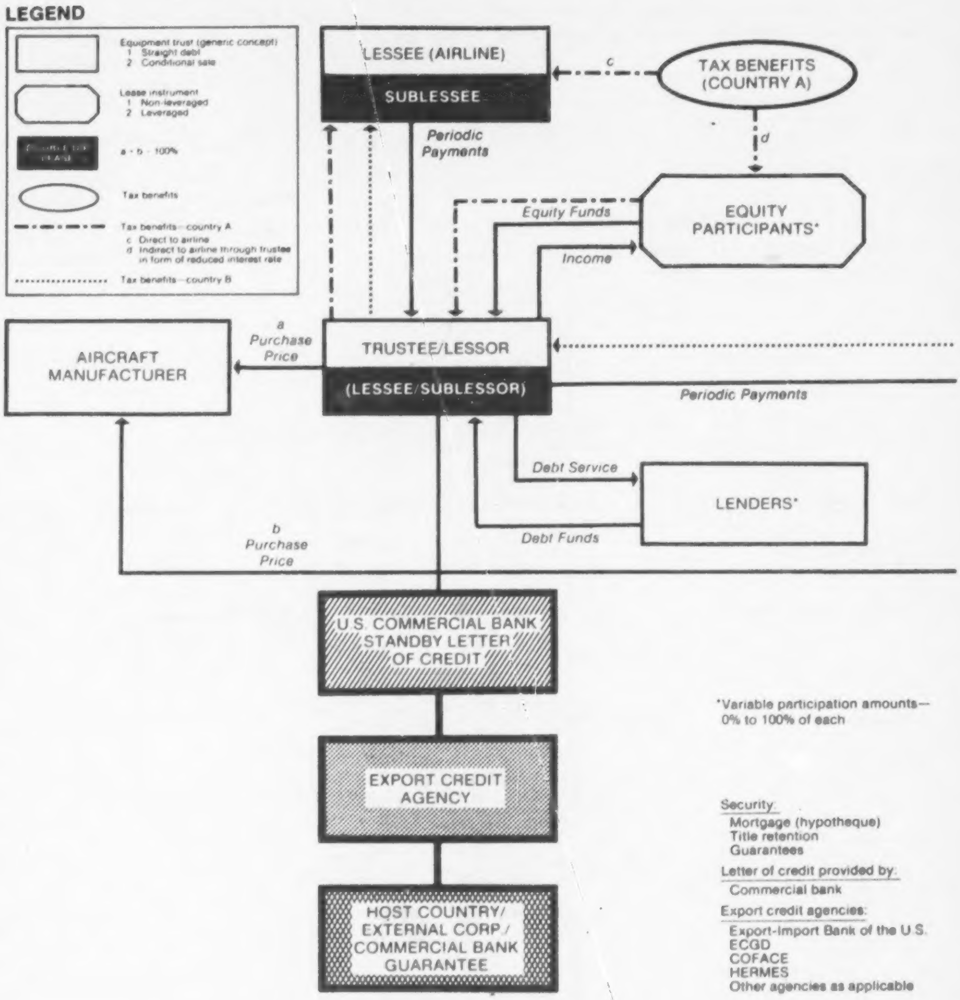

AIRLINE (LESSEE)
Purchase Agreement
Assignment of Purchase Agreement
Lease Agreement
Equity Funds
Periodic Payments
AIRCRAFT MANUFACTURER
Title
Purchase Price
TRUSTEE (LESSOR)
Equipment Trust Certificates
Debt Funds
Debt Service
Trust Agreement
LENDERS
Letter of Credit
Letter-of-Credit Fee
Security Interest
Agreements
Cash flows
U.S. COMMERCIAL BANK (STANDBY LETTER OF CREDIT)
Letter of Credit
Full Faith and Credit Guarantee
Guarantee Fee
Security Interest
EXPORT CREDIT AGENCY

FIGURE 5

INTERNATIONAL EQUIPMENT TRUST FLEXIBILITY

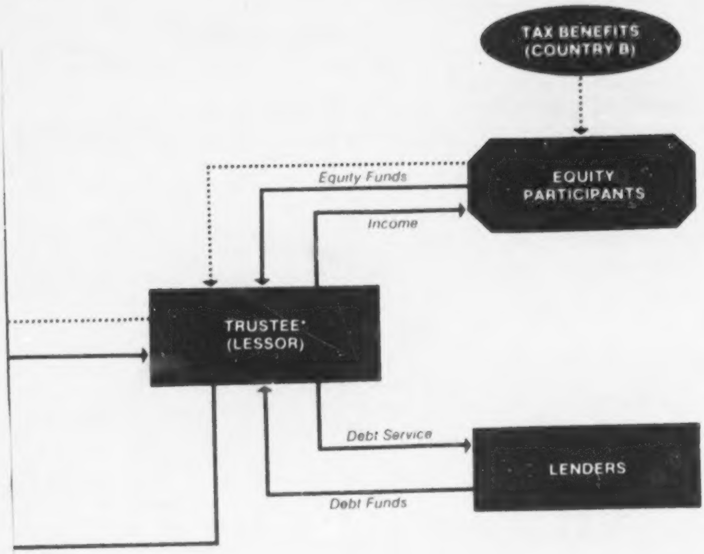

LEGEND
Equipment trust (generic concept)
1 Straight debt
2 Conditional sale
Lease instrument
1 Non-leveraged
2 Leveraged
a + b = 100%
Tax benefits
Tax benefits—country A
c Direct to airline
d Indirect to airline through trustee in form of reduced interest rate
Tax benefits—country B
LESSEE (AIRLINE)
SUBLESSEE
c
TAX BENEFITS (COUNTRY A)
d
Periodic Payments
EQUITY PARTICIPANTS*
Equity Funds
Income
a Purchase Price
AIRCRAFT MANUFACTURER
TRUSTEE/LESSOR
(LESSEE/SUBLESSOR)
Periodic Payments
Debt Service
LENDERS*
Debt Funds
b Purchase Price
U.S. COMMERCIAL BANK STANDBY LETTER OF CREDIT
EXPORT CREDIT AGENCY
HOST COUNTRY/ EXTERNAL CORP./ COMMERCIAL BANK GUARANTEE

*Variable participation amounts—0% to 100% of each

Security:
- Mortgage (hypotheque)
- Title retention
- Guarantees

Letter of credit provided by:
- Commercial bank

Export credit agencies:
- Export-Import Bank of the U.S.
- ECGD
- COFACE
- HERMES
- Other agencies as applicable


TAX BENEFITS
(COUNTRY B)
Equity Funds
EQUITY PARTICIPANTS
Income
TRUSTEE*
(LESSOR)
Debt Service
LENDERS
Debt Funds

Funding (Debt/Equity)

Underwriters:
- Investment banks
- Merchant banks
- Commercial banks

Sources:

Medium term:
- Commercial banks
- Merchant banks
- Investment banks

Long term:
- Insurance companies
- Pension funds
- Trusts
- Savings & Loan Associations

Issues:
- Public offerings
- Private placement
- U.S. bonds
- Eurobonds
- FRN's
- "Yankee" bonds
- "Bulldog" issues
- Euro-DM bonds
- "Samurais"
- Convertible bonds
- Etc.

Currencies:
- U.S. dollars
- Canadian dollars
- DM
- Yen
- U.K. sterling
- Swiss Fr.
- Guilder
- French Fr.
- Other FX

Interest rates:
- Fixed
- Floating
- Adjustable rates:
  - Fixed-floating
  - Drop-lock
  - Index-linked
  - Etc.

Repayment:
- Level principal plus interest
- Level principal and interest
- Fluctuating
- Balloon
- Grace period
- Etc.

FLEXIBILITY OF THE IET

In the IET model discussed above, the institutional lender supplies the cash and owns the asset beneficially. A commercial bank takes the credit risk and is in turn guaranteed by the full faith and credit of the exporter's government. As indicated, many variations on this basic structure are possible (Figure 5). One variation concerns the distribution of credit. For instance, medium-term lenders might supply funds for the first 5 years of the loan, while institutional lenders take the latter maturities. Moreover, funds may be provided in various currencies. Multicurrency financing offers total cross-mobility of capital and maximum flexibility to international carriers generating revenues in more than one currency.

Other variations concern the amount of risk each lender takes. Medium-term lenders may be unsecured, or unguaranteed. Some long-term lenders may be willing to trade a guarantee for a higher rate of return. Other major variations concern the structure of the loan instrument. Various parts of the loan might be offered at fixed, moving-fixed, or variable rates. Amortization of loan principal might also vary, to better coincide with airline cash flows.

Transactions might also vary in their legal form. For example, the trust format may not fit easily into civil law jurisdictions, where agency or management concepts might be more useful.

The great variation from country to country in laws relating to title, registration, tax treatment, protection of creditors, accounting practices, and the like, will make different legal forms for different transactions advisable. **Conditional sale agreements, hire purchase agreements, leases (including "double-dip" leases), chattel mortgages, as well as equipment trusts are all compatible with the fundamental principles of the IET.**

THE CAPACITY AND AVAILABILITY OF PRIVATE CAPITAL MARKETS

The ability of the private capital market to absorb the funding requirements arising from use of the IET is a function of the many factors appearing in the preceding diagram. The impact of the IET on private capital markets will be manageable for several reasons. First, not all airlines will need to use official guarantees. An international airline, with a well-recognized credit rating and its own host-country guarantee, may avoid the added cost of the guarantee fee by going to the market in its own name. Second, carriers who need the guarantee will use it as market conditions dictate and only to the extent necessary to tap the private capital market sources which would otherwise be unavailable due to term restrictions or legal and administrative guidelines (such as the insurance companies' "basket rules"). Third, the IET structure requires the use of the guarantee device only for the latter maturities where qualification and accessibility are the key constraints.

The IET will also facilitate access to the private capital markets for developing nations which will have the greatest relative demand for new aircraft in the future. However, direct government funding of the latter maturities may be required if the private market can not respond effectively to these airlines' needs. Such direct government funding need not necessarily be subsidized, but its presence through the cross-default provision enhances the mobilization of private capital. Governments might participate through export agencies or multinational sources (such as the World Bank or various development banks). These sources may serve as direct lender, guarantor, or a combination of both.

THE TRANSITION TO PURE ASSET FINANCING

Toward the Elimination of Guarantees

Equipment trusts were originally developed as a sophisticated form of asset financing. Their use in combination with governmental guarantees in the field of international aircraft financing should be viewed with this original purpose in mind.

As institutional lenders become accustomed to making guaranteed loans in the international market, the desire for a higher return on investment will likely prompt some long-term lenders to lend without the security of a government guarantee. Domestication of the credit, when needed, could be met through the use of U.S. commercial bank letters of credit alone.

The commercial bank which takes the credit risk will require, in addition to the guarantee of the host country, a security interest in the aircraft and adequate insurance against risk of loss on the loan due to political risks.

The Collateral

It is of great importance to a secured lender to be able to repossess the security in the case of a default and to realize the full amount of unpaid principal and interest if the collateral is sold. Because of their mobility and high resale value, commercial jet aircraft are particularly valuable security.

The great mobility of commercial jets offers several benefits for secured creditors. Unlike physically fixed capital assets, aircraft are not physically bound to the country of the airline's nationality. The procedures that give the creditor possession of the aircraft and the issues associated with repossession will vary from country to country. However, once the aircraft has been repossessed, it can be removed to a jurisdiction chosen by the creditor. In addition, aircraft used in international transportation are likely to spend some time in jurisdictions that permit repossessions in a timely manner, allowing the creditor to do a limited amount of shopping for the most favorable legal system.

Once repossessed, the aircraft can be subjected to the creditor's control and used to satisfy the debt. Although it is not possible to generalize concerning the ease with which an aircraft can be respossessed under local law, the trustee's interest in an aircraft, properly recorded in the country of registration, will be accorded priority over competing interests in those countries which have signed the Convention on International Recognition of Rights in Aircraft, the Geneva Mortgage Convention. Of course, recognition of the interest does not guarantee summary enforcement of a lessor's rights in the event of a default. Moreover, in countries not party to the Geneva Convention, the validity and priority of conflicting interests in aircraft will be treated under the laws of the jurisdiction in which enforcement is sought. That jurisdiction may look to the law of the country in which the aircraft is registered, the law of the lessor's domicile, or the law of the place of enforcement. Nevertheless, in many jurisdictions, the chief obstacles to repossession are likely to be fundamentally political, not legal.

Political Risks

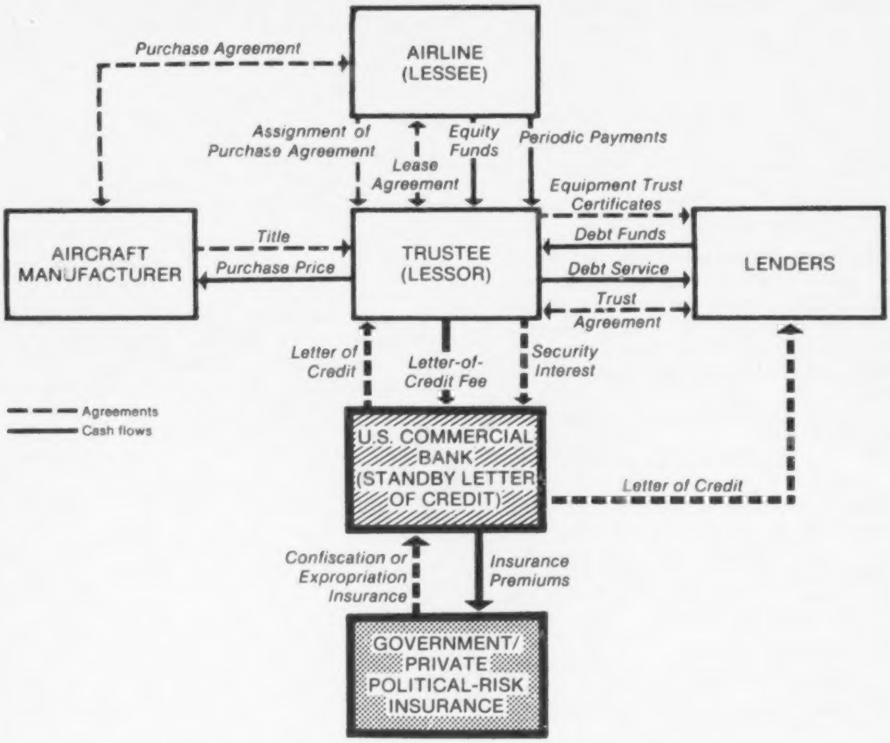
In many jurisdictions, a risk facing the secured creditor is that the host country will prevent or delay his recovery of the asset in the event of a borrower's default. Because of this risk, export credit agencies must develop adequate political-risk insurance programs before government-guaranteed financing can change to pure asset financing (Figure 6).

The term of the insurance must match the tenor of the loan in order to provide the necessary comfort to long-term lenders. The development of such insurance is a necessary precondition to the removal of government guarantees from international aircraft financing. Insurance would likely be preferred over guarantees by the U.S. government, if not other governments, since insurance is oriented toward political—not credit—risk and does not preempt available government resources.

Although a significant private market in long-term political risk insurance might develop, the writing of such insurance will likely remain a government preserve. In most instances, the "host country"—the airline's home country—guarantees the airline's obligation. The exporter's government, as insurer, will likely have more leverage in dealing with the host country than would most financial institutions.

FIGURE 6

INTERNATIONAL EQUIPMENT TRUST FINANCING
With U.S. Commercial Bank Letter of Credit and Government or Private Political-Risk Insurance


Purchase Agreement
AIRLINE (LESSEE)
Assignment of Purchase Agreement
Lease Agreement
Equity Funds
Periodic Payments
Equipment Trust Certificates
Debt Funds
Debt Service
Trust Agreement
AIRCRAFT MANUFACTURER
Title
Purchase Price
TRUSTEE (LESSOR)
LENDERS
Letter of Credit
Letter-of-Credit Fee
Security Interest
Agreements
Cash flows
U.S. COMMERCIAL BANK (STANDBY LETTER OF CREDIT)
Letter of Credit
Confiscation or Expropriation Insurance
Insurance Premiums
GOVERNMENT/ PRIVATE POLITICAL-RISK INSURANCE

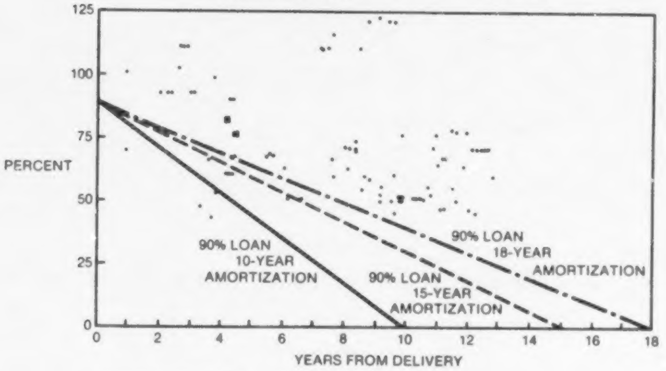
Aircraft Asset Value Retention

When adequate legal and insurance mechanisms are in place, the long-term lender must also be assured that the asset will retain sufficient resale value over the course of the loan to be able to repay all principal and interest due at any time. It has been well-documented that jet aircraft retain a significant fraction of their original price over long periods of time (Figures 7, 8, 9). Due to substantial secondary markets for commercial jets, it is reasonable to assume that the new generation of aircraft soon entering service will also retain their asset value.

FIGURE 7

727 RESALE PRICE* AS PERCENT OF ORIGINAL PRICE

	NO	%
RESALE TRANSACTIONS	97	100
SOLD AT PRICE IN EXCESS OF LOAN BALANCE		
10-YEAR AMORTIZATION	93	96
15-YEAR AMORTIZATION	86	89
18-YEAR AMORTIZATION	86	89

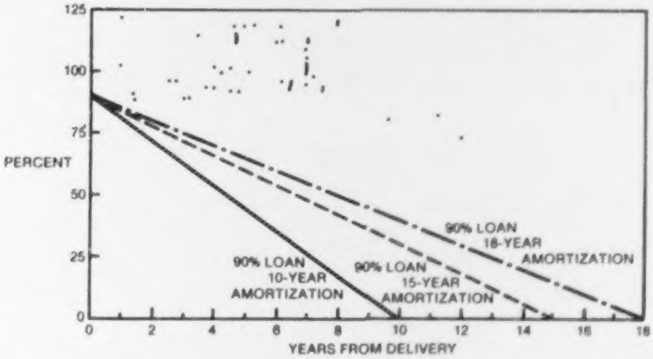


*Based on actual historical data, 1969-1980, all transactions known to Boeing

FIGURE 8

737 RESALE PRICE* AS PERCENT OF ORIGINAL PRICE

	NO	%
RESALE TRANSACTIONS	63	100
SOLD AT PRICE IN EXCESS OF LOAN BALANCE		
10-YEAR AMORTIZATION	63	100
15-YEAR AMORTIZATION	63	100
18-YEAR AMORTIZATION	63	100

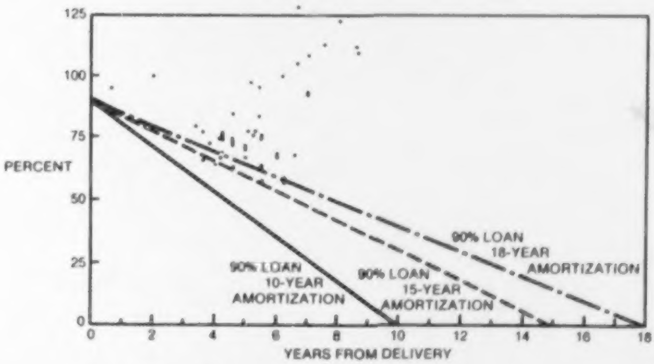


*Based on actual historical data, 1972-1980; all transactions known to Boeing

FIGURE 9

747 RESALE PRICE* AS PERCENT OF ORIGINAL PRICE

	NO	%
RESALE TRANSACTIONS	50	100
SOLD AT PRICE IN EXCESS OF LOAN BALANCE		
10-YEAR AMORTIZATION	50	100
15-YEAR AMORTIZATION	48	96
18-YEAR AMORTIZATION	44	88



*Based on actual historical data, 1974-1980; all transactions known to Boeing

CONCLUSION

Commercial jet aircraft provide adequate security to justify extending long-term credit to creditworthy airlines, without the need for direct credit participation or guarantees by the exporter's government. In the current environment created by substantial aircraft export credit subsidies, the development of long-term credit facilities has been discouraged.

Given a satisfactory financial climate and a flexible, but temporary, government guarantee program, instruments can be developed which eliminate such subsidies and encourage innovative financial approaches to aircraft financing. The International Equipment Trust is a proposal which, when carried to its logical conclusion, will bring the benefits of free and open competition to the aircraft manufacturers (including their international production consortiums), the financial community, and the airlines. At the same time, the treasuries and taxpayers of all exporting countries can be freed from the need to continue the past practice of extensive export credit subsidies.

The export agencies and their governments have the ultimate responsibility for negotiating the international agreements that will permit the implementation of this proposal.

Please address comments and requests for additional information to:

Aerospace Industries Association
1725 De Sales St. N.W.
Washington, D.C. 20036

Mr. **Bailey**. You mentioned the development cost and research, naturally today's military environment and aerospace industry, are just absolutely vital.

You commented on research and development, the spinoffs and effect that the Government disengagement in that area has on your industry. What has the trend been in other countries, France, Britain, Brazil? You know you talk about this Brazilian imposition. The chairman asked a very good question, what you folks are doing about it. I have another one, what we are doing about it as a government? How does Brazil approach this thing? They targeted that particular area?

Mr. **Harr**. They did.

Mr. **Bailey**. How did they do that?

Mr. **Harr**. I cannot answer that.

Mr. **Bailey**. What role does the Government play?

Mr. **Harr**. A substantial role, all the way from development through supporting, assisting, protecting and aggressively running interference for the marketing efforts. I suppose we could take a little black eye for not having targeted that area ourselves.

Mr. **Bailey**. That was going to be the next question. Brazil is doing this——

Mr. **Harr**. Not only Brazil, sir.

Mr. **Bailey**. They are targeting a certain product line or product area. Obviously they see some kind of gap out there. You are not going to move into it if you are going to get outmaneuvered on finance costs. Is Brazil doing this all over the world? Have they hit on a need that you should have, and if they have, what are you doing about that? Are you planning as an industry to compete with that market, or if you are, how? Are you frightened away from it because of things like these financial arrangements? Can you tell me more?

Mr. **Harr**. As I say, no, we are not frightened away from it. We are pretty confident that we can compete, even today and in the foreseeable future, unless the rules go haywire. But when you say "Is industry planning?", obviously industry does not plan in this country—a whole industry does not plan. Boeing plans and tries to keep it secret from Lockheed first, and then from the foreign countries.

Mr. **Bailey**. You do not know if anyone is currently——

Mr. **Harr**. Yes, sir, they are.

Mr. **Bailey**. They are planning to go after that market?

Mr. **Harr**. Some are already doing it. The Airbus to some extent slipped into a market gap, too.

Mr. **Bailey**. Airbus: The chairman asked a question and I heard the same thing about the quality of that airplane. You made an allegation in the statement which is a very important one. You made an allusion, let me say. It was not explicit, but it is a very, very important one. You intimated that somebody out there wanted to buy American aircraft and apparently I guess thought that American aircraft were superior to Airbus, but did not do so apparently because of the financial package. I am not talking about country X, Y, or Z that is involved in the research, developing, and marketing of the aircraft, the relationship between the company in that particular country and their government. I am talking about that third-party purchaser out there who buys that aircraft. The aircraft really does not meet their need. Financing being equal they would buy American aircraft—is that true? And if that is true, I would like to try to get some details on that.

Mr. HARR. When you are talking about the Airbus, you are talking about a competitive aircraft, an aircraft people could choose for its own merits. But still, when you consider the worldwide market, and let us assume that the American competitor is at least as good, but not necessarily decisively superior, then as you go around the world, in every market you go into, the Airbus is going to have a leg up just on financing.

Mr. BAILEY. That is not the question. Do you know of a case where somebody decided to contract for Airbus.

Mr. HARR. Why do you not go further and take inferior aircraft that they bought because of financing? We believe this has happened and is happening, but we would be reluctant to give examples because of the word "inferior." It is too sensitive to couch in those terms.

Mr. BAILEY. Do we have an airplane as good as Airbus?

Mr. HARR. I am saying for all purposes, we have more than one, but let us take, say, the 767 that is coming from Boeing now and compare it with the Airbus. We think the 767 is a lot better, but people could argue——

Mr. BAILEY. Roughly comparable?

Mr. HARR. Yes.

Mr. BAILEY. Do you have a purchaser saying I would rather pick your plane but I am going to pick Airbus because of the financing?

Mr. HARR. Sure. They don't say it like that.

Mr. BAILEY. I am not saying they are going to put their hand on a bible for you.

Mr. HARR. Have we lost sales just because of financing, yes.

Mr. BAILEY. You have lost sales, contracts went to Airbus as opposed to American companies because purchasers would have preferred, all things being equal with the exception of the financing package or whatever they throw in with it they would have preferred to buy American aircraft and buy Airbus because financing is cheaper?

Mr. HARR. That is my statement, yes.

Chairman GIBBONS. Mr. Frenzel?

Mr. FRENZEL. Thank you very much for your testimony, Mr. Harr.

You have been concerned with interest subsidies, and you mentioned that we had made at least a little progress in OECD agreements, one relating to aircraft specifically and the other of general nature.

Can you tell us what you think of the prospects for the future to achieve a more even sort of agreement between the industrial countries that would affect the interest subsidies?

Mr. HARR. The major thrust of our activities now, Mr. Frenzel, is to sell that proposition to our own Government and to our principal foreign competitors. We are in full dialog with them and have been for some time. They don't agree with some of our versions of what their subsidies are and so forth, and they are also prodded by the fact that there is a rationale that makes it attractive to them to offer lower rates. We point out to them that it is costing their governments and their taxpayers or whatever substantial amounts of money over a long period of time, and that the United States—as long as Eximbank provides another kind of credit that would enable us to have competitive interest rates—is not going to quit. There is a bill in this Congress to have a war chest to counter predatory financing.

Mr. **Frenzel**. Are you supporting that?

Mr. **Harr**. We support that, yes, as a means of conveying the message to our foreign competitors that they are just hurting themselves, it is no way to go and we are not going to quit, our Government is going to support us and we are going to fight for fair marketplace considerations to prevail in the purchase of aircraft. A lot of progress is being made with that.

Mr. **Frenzel**. I get the impression that where France was the most recalcitrant in the past, perhaps our biggest duty now lies with Japan, and they are certainly not a major exporter of aircraft.

Mr. **Harr**. Yet.

Mr. **Frenzel**. Maybe we ought to go forward and try to negotiate a separate agreement with those who will negotiate. Principally the OECD. Do you have any thought about that?

Mr. **Harr**. We should take any opportunity we can find; yes, sir.

Mr. **Frenzel**. And while we are trying to negotiate this, and I think the two OECD agreements were two of the few good developments in world trade of last year—you are aggressively pushing for increases in Eximbank financing until we achieve the rate level?

Mr. **Harr**. Yes, sir. That is the only option we have.

Mr. **Frenzel**. So, you support the creation of a so-called war chest and also an increase in funding for Eximbank?

Mr. **Harr**. Yes, we do, sir.

Mr. **Frenzel**. So do I.

Thank you.

Chairman **Gibbons**. Mr. Schulze.

Mr. **Schulze**. Thank you, Mr. Chairman.

Mr. Harr, I wonder if you would expand a little bit. When Mr. Frenzel referred to the Japanese, you said they are not a big problem yet.

Mr. **Harr**. Well, they have stayed out of major aircraft development thus far, but they have plans which they are freely talking about now—they have an aircraft in mind of 120- to 150-seat capacity now called the YXX, I believe. They are aggressively entering into discussions with non-Japanese manufacturers of airframes and engines, including American, but also including French and British.

Mr. **Schulze**. Do they have a joint venture underway?

Mr. **Harr**. Yes. They have some with us and I guess they are about to have some with others.

Mr. **Frenzel**. Would the gentleman yield.

Mr. **Schulze**. Yes.

Mr. **Frenzel**. Do you know what percentage they have of the private aircraft market?

Mr. **Harr**. They make a YS–12. It is very small, but I will get you the figures.

Mr. **Frenzel**. It isn't significant?

Mr. **Harr**. It is not significant now.

Mr. **Frenzel**. Then never mind the figures.

Mr. **Schulze**. Do you see them making a major effort to penetrate those markets in the future? I understand they are.

Mr. **Harr**. I think they will, because the market is so attractive. You are talking about $120 billion in large aircraft. We are talking, in the next decade, about $130 billion and that may be low.

Mr. **Schulze**. Do they have content requirements?

Mr. **Harr**. I do not know yet. You may be sure—you mean local content requirements? You may be sure there will be some package of that kind.

Mr. **Schulze**. I think there are.

Mr. **Harr**. I think so too.

Mr. **Schulze**. I understand that there are. I think if there are local content requirements in their aircraft that we should have local content requirements in their automobiles.

I am sick and tired of us opening our markets, they are keeping that market closed until they develop the product and then penetrating our markets. Can you tell us about the joint venture that you have—have you started or are you just working on one?

Mr. **Harr**. Boeing has one with them and I can't give you the details off the top of my head.

Mr. **Schulze**. Mr. Harr, I am also concerned about the aircraft, avionics, and aerospace industries, opportunities for R. & D. Do you have any specific suggestions of things that we can do to create incentives or at least give you some neutrality when funds are invested in R. & D.?

Mr. **Harr**. Well, we as an industry I would say, Mr. Schulze, have supported the President's economic package enthusiastically, its thrust and its purpose, and have fallen off the wagon only in two areas. One area: We did not consider the proposed Eximbank cutbacks wise—we thought they were and are pennywise and pound foolish, because we don't think the Eximbank should be in the unified budget anyway. It is a lending agency, not an expending agency. We found the basis to clearly distinguish between the two. The other area in which we disagree with the administration's package was the size of the aeronautical R. & D. budget in NASA. The reason for that is that for all these years, going back to NACA, the predecessor to NASA, the Government has been in a partnership with American industry that has produced brilliantly to a considerable extent—and that has been a major element in giving us our aeronautical parameters.

NASA has a large research plant in terms of research facilities. They have facilities for programs that no private industry is going to be able to match. What we are doing is jeopardizing 10 years down the road what we have now for the want of a very small outlay of Federal dollars. We are risking breaking up teams that have been put together carefully over the years. We are insuring that some of the basic research that will be required to come to fruition a decade from now will not be done.

Chairman **Gibbons**. Our Japanese PA system went off. You will have to kind of raise your voice.

Mr. **Schulze**. Mr. Harr, do you see any mechanism or any way that we can provide any assistance, perhaps even through the Tax Code to take up some of this slack?

Mr. **Harr**. I would welcome it. If you will let me think about that and come back, I would appreciate the opportunity to do so.

[The following was subsequently received:]

While we would stress that tax incentives can never be a satisfactory substitute for a vigorous research effort on the part of the government in the aeronautical area, we would welcome the following changes in the Tax Code as a complementary initiative: (1) Any R. & D. funded by a company should be made eligible for the investment tax credit, including R. & D. performed under government contract; and (2) the benefits of DISC should be retained, either in the present form or modified to conform to international trade agreements.

Mr. **Schulze**. I also agree with your statement on financing and quite frankly I think if we gave Bill Brock $25 billion that he wouldn't have to spend much of it, that he could go to the French and say if you are going to 7 percent, we will go to 5 percent. If you want to go to 5, we will go to 3 and play in that poker game.

I think if he had a large enough pot he could back them down and we could compete on a regular basis. I agree that we need more money from Eximbank to support that more vigorously.

Thank you.

Mr. **Bailey**. I want to say that I was delighted to hear your comments about the space industry. I think it is vital to our country. I very much agree with the things that you have said here today, but have reached a different conclusion. I support for those reasons the President's program. I just want you to know that.

Chairman **Gibbons**. Thank you, sir. We are going to have to adjourn until 1:30 until we get this PA system fixed. We will see you all at 1:30.

[Whereupon, at 11:55 a.m. the hearing was adjourned to reconvene at 1:30 p.m.]

AFTERNOON SESSION

Chairman **Gibbons**. Our first witness this afternoon is from the Tanners' Council of America, Elinor D. Talmadge.

STATEMENT OF PAST PRESIDENT EUGENE L. KILIK AS PRESENTED BY ELINOR D. TALMADGE, PRESIDENT, TANNERS' COUNCIL OF AMERICA

Ms. **Talmadge**. Mr. Chairman, I have become president of the Tanners' Council as of January 1. The testimony that was submitted to you earlier in December was submitted by Mr. Eugene Kilik, who retired as of December 31. So with your permission, I will just read his testimony, and then ad lib to give you an update of the last 8 weeks.

Chairman **Gibbons**. All right. And I want to say—I remember your inviting us to lunch, many of us, in fact I think the whole Congress, to meet your constituency, and I thought it was a very impressive meeting. I thought it went very well.

Ms. **Talmadge**. Thank you very much.

The Tanners' Council of America is the trade association representing practically the entire U.S. leather tanning industry. Since hides and skins are available in almost every country of the globe, and since leather is manufactured practically everywhere, I represent an industry to which international trade is vital to its very existence.

We would like today to address some of the trade issues before us, and to urge the Congress to take aggressive action to help induce industry's access to markets.

If theory were practice, the U.S. tanning industry would be on top of the world in international trade. Because of the efficiency and productivity of our friends the cattlemen, we have a large, plentiful supply of the finest raw material in the world for making leather. We in the United States are blessed with the hardest working, most efficient labor force of any tanning industry.

The management and organization of the U.S. tanning industry are superior to those found any place else. Our willingness to invest in new plant machinery and pollution control equipment is unmatched. The productivity of the U.S. tannery worker is double that of the most efficient competitor work force in industry elsewhere.

Nevertheless, we are here, frustrated and angry, because we are losing out in our battle for our rightful market place. In but 2 years out of the past 10 have we had a postive trade balance for leather.

In 1980 we exported nearly 300 million dollars' worth of leather. The U.S. tanning industry, enjoying a natural comparative advantage over any country in the world, naturally espouses a free trade policy. We strive for free access to raw material supply and free access to markets. In these efforts we are aided by the U.S. Government. Our objectives are their objectives. What we try to achieve, they try to help us in the accomplishment. Nevertheless, we can report practically no progress.

Trade barriers in many places of the world thwart the acceleration of exports.

Why is an industry which has a comparative advantage in every respect, plus the cooperation of the U.S. Government and its able trade negotiators, a failure? Furthermore, why are other U.S. industries which enjoy the same kinds of comparative advantages also suffering the same sort of unfavorable trade results? Is it really true, as the Japanese say, that we do not try hard enough?

The answer is a strong no. We do try hard enough, and our efforts would be effective if trade were a game played by the rules that we understand to be fair and proper.

As an example of how other countries act relative to our ideal, I will cite two recent instances; the first with Japan, the second with Argentina.

As part of our campaign to open markets for leather, naturally our most important target was and is Japan. Japan maintains highly restrictive quotas on imports of leather and a tariff that is so high that even with the absence of quotas it would be extremely difficult to sell leather there. But most important, Japan depends on U.S. hides for 80 percent of its raw material supply.

Consequently the Tanners' Council took advantage of section 301 of the Trade Act of 1974 and petitioned the President to take actions which would lead to access to the Japanese market. The United States demanded that they open their market; the Japanese industry protested vehemently. They said that if the slightest bit of access were granted their industry would disappear and the poor, downtrodden workers in the cottages and hamlets of Japan would be without employment.

For 18 months after filing our petition the Japanese did nothing but stonewall any action. Finally, after a U.S. complaint to the GATT, and publication in the Federal Register of a list of retaliatory measures, the Japanese agreed to talk. An agreement was reached whereby the Japanese agreed to a special import quota for U.S. leather.

As a result of this agreement, U.S. tanning companies invaded Japan en masse. About 30 U.S. companies participated in a Joint Tanners' Council/Foreign Agricultural Service exhibit at the Tokyo trade show. The results were nothing. Our performance was repeated the following year, and again nothing. Today, after 3 years, approximately 14 percent of the quota so generously awarded by the Japanese is utilized by U.S. tanners.

Mr. Chairman, I might add here that the quota amount represented 3 percent of the Japanese leather market. So that means they have facilitated 14 percent of 3 percent, which is a half a percent, which is very near zero.

Chairman GIBBONS. Are you going to elaborate more on that as you go along?

Ms. TALMADGE. I would be happy to. The Japanese tanners were just here last week, so it is very fresh.

Would you like me to elaborate now?

Chairman GIBBONS. I want to know why.

Ms. TALMADGE. There are several reasons.

One of the big obstacles to trade is their distribution system.

We have a list of about 50 companies who have licenses specifically to import U.S. leather. But they use the licenses as vehicles for keeping out the leather, because they are allowed to have the licenses and not use them, which is exactly what is happening.

So what gets into Japan is the upholstery leather which is used in the Hondas and Toyotas for reexport.

I took——

Chairman GIBBONS. Where are they getting their leather from?

Ms. TALMADGE. They are getting the hides from the United States. In the distribution system, few of the tanners have the capital—it is the trade brokers who buy the hides, they then buy the finished leather, they then sell the leather to the manufacturers and in some cases the big companies then buy and sell the finished leather products.

Chairman GIBBONS. They just insist upon doing all of the valueadded in Japan, is that right?

Ms. TALMADGE. That is right.

Now, we have tried to establish a joint venture where the joint venture would have the unused portion of the quota. There are a lot of American tanners who have signed up to participate, but we are still working on getting participation on the other side. So that is one problem, is the distribution.

The other problem is the 20-percent tariff. We think that if the tariff were removed, it would certainly help trade, but it would not necessarily insure——

Chairman **Gibbons**. You have little or no tariff on hides, but a very high tariff on finished leather?

Ms. **Talmadge**. That is right, that is exactly right.

Chairman **Gibbons**. And a quota on finished leather?

Ms. **Talmadge**. Yes.

Chairman **Gibbons**. And no quota on hides?

Ms. **Talmadge**. That is right.

So they take about 50 percent of the U.S. hides, and they can pay higher than a lot of people, so they get what they want in U.S. hides, but then they refuse to allow the leather to come in.

Now, the agreement terminates——

Chairman **Gibbons**. Can they do this work more efficiently than we can, is there a labor advantage?

Ms. **Talmadge**. They have different excuses. About 20 years ago they said they had an unfavorable trade balance. And then when that was no longer an excuse, they blamed it on poor quality. And we say, but we sell leather to about 90 countries—Italians, all over Europe. American tanners can make any kind of leather.

They then say that the distance is too great. We said all right, we will have a joint venture. The big problem, though, is not really the quota——

Chairman **Gibbons**. The distance is too great for the leather but not for the hides?

Ms. **Talmadge**. That is right. And of course it costs more to ship the hides than the leather, because they are much heavier.

Chairman **Gibbons**. Go right ahead.

Ms. **Talmadge**. The Japanese, by sleight-of-hand, magic, tradition, or downright subterfuge, have been able to see to it that in spite of the agreement, in spite of the U.S. comparative advantage, nothing can happen.

Last week when the tanners were here, I was very proud because we had a small dinner where the Deputy Assistant Secretaries from Agriculture and Commerce and USTR came, and we all went around the room lambasting the Japanese. I think they are getting the message, that there has to be some progress. But I do not know.

The agreement with Japan will expire the end of March. We and USTR are putting our heads together to try to figure out what to do next. It seems that whatever we can think of, the Japanese can find a way to circumvent. Whatever will be agreed upon, the Japanese will find a way to make the agreement ineffective.

The second example I would like to cite is that of an agreement that was reached with the Government of Argentina.

Chairman **Gibbons**. Before you go on, let's go back to the Japanese situation, because it really worries me. I find what you talk about here happens quite often in Japan. I know they do it in a number of products.

Are these government barriers, or are these business barriers outside of government? Have you been able to identify which are the barriers holding you out?

Ms. **Talmadge**. It is a very complicated situation.

We prefer to talk about the economic barriers. In truth, there are some social barriers also.

I think——

Chairman **Gibbons**. You are talking about government-imposed economic barriers? The tariff and the quotas?

Ms. **Talmadge**. That is right. The Japanese get an allocation for imports, and they don't use it, so the import license, as I said earlier, is a vehicle for keeping out the imports rather than facilitating the imports. The high tariff is a further deterrent.

Chairman **Gibbons**. How do they give out these import quotas? Are they auctioned? They obviously are not.

Ms. **Talmadge**. We are not sure about that. They are not auctioned.

Our understanding is they are distributed for political reasons.

Chairman **Gibbons**. Like orange quotas?

Ms. **Talmadge**. I imagine very similarly. Whether or not the Japanese have to actually pay cash—I have heard conflicting information about that.

Chairman **Gibbons**. Well, I have always tried to be at least fair with the Japanese on their economic programs. But I too am running out of patience. These kind of things have to stop.

I hope that you will keep me posted—I am very interested in what you are talking about.

Ms. **Talmadge**. Thank you, Mr. Chairman.

I think they really do not believe entirely that the Government will retaliate.

Chairman **Gibbons**. If the executive branch cannot deliver the message, I will go back over there again and we will get it delivered.

Ms. **Talmadge**. I will give you a briefing paper when you go.

Chairman **Gibbons**. All right. Thank you.

Ms. **Talmadge**. The second example I would like to cite is that bilateral agreement that was reached with the Government of Argentina. This agreement called for increased access to Argentine hides in exchange for U.S. concessions on duties on leather, corned beef, and trade concessions on cheese. Argentina defaulted. They just failed to live up to what they had agreed.

Now USTR is trying to negotiate a modification and we, the Tanners' Council, have filed a complaint under section 301 of the Trade Act alleging unfair practice.

Argentina originally had a total embargo against hides. In exchange for lifting the embargo, they would have a 20-percent tariff and reduce that by 5 percent every 6 months. They have failed to go from 10 percent to the 5 percent and then to zero. We have honored our side of the agreement. We removed our tariff on leather to zero for 1 day, and then went back up to 1 percent. The April 1981 level, is where the Argentines are now also.

In both the Japanese and Argentine cases a relatively small industry has had to go to the legal expense and work with the Government first to get an agreement. When the signatories are in default, we are again going back to our lawyers to pressure the Government to see that these agreements are honored.

I do not think it is appropriate for me to be too candid on the situation in Argentina, because we have submitted our rebuttal brief, and their brief is in. USTR is reviewing the 301 case. I think I should not speak too much in a public forum about that, except to say that once again we have said that we greatly prefer having an agreement and getting the Argentines back onstream on the agreement as opposed to proceeding with the 301 case.

I have said publicly, though, that I believe they are behaving very arrogantly. They have refused to renegotiate. They, too, do not believe that the United States will retaliate. They have told our members that. So it leaves us in a very frustrating position.

It seems that no matter what we do, our efforts are doomed to frustration and ineffectiveness. Our policies are very much in accord with the policies of the U.S. Government. All concerned on the U.S. side are interested in freer access to raw materials and freer access to markets. The question is, why, with the best of cooperation, have we achieved so little and, perhaps more importantly, what can we do to get better results in the future.

It would be wonderful if I, or anyone else, could offer solutions that would assure success. However, those of us who have given our trade problems a great deal of thought and who have had the day-to-day experience of being with trade problems with various countries realize that there is no single answer. There is no grand scheme or revolutionary program that will all of a sudden give U.S. industry and U.S. agriculture the fair treatment that the United States grants our competitors.

Quite the contrary, if progress is to be made in the trade area, it is likely to be made in very small steps, piece-by-piece, industry-by-industry, issue-by-issue. We must be more patient than the oriental and more forceful and resourceful than the Europeans. At the same time, we must be compassionate and giving toward the third country powers who will eventually be our most favored markets.

While I have no great blueprint for what we ought to do, I have two minor suggestions. The first suggestion is to place greater emphasis on sectoral or product negotiations. Ambassador Brock used this approach very successfully in the recently concluded agreement with Japan on semiconductors. This sectoral or industry approach should be broadened to include other products, like oranges.

For example, the U.S. tanning industry is upset because Japan is free to compete with us for U.S. hides, but we are not provided an equal opportunity to sell leather in Japan.

Argentina can sell its leather to the United States at a nominal duty of 1 percent, but the U.S. tanner is restricted when he wants to buy Argentine hides.

I might also add the Canadians can take U.S. hides free. We have to pay 15-percent tariff to ship U.S. leather into Canada.

Mexico the same thing. They take U.S. hides. It is a 20-percent tariff, plus a very complicated labyrinth of a distribution system there, too.

There are industry and agricultural advisory apparatus set up under the Trade Act. Better use of this advice should be taken by the U.S. Trade Representative and the Departments of Agriculture and Commerce. It should be industry's obligation to advise; it is the Government's duty to take this advice into account in furthering U.S. trade interests.

The second suggestion is to broaden and strengthen the Office of the U.S. Trade Representative. At present this office is staffed by a group of professionals who have learned the complexities of reaching agreements which are effective in pursuing the long-term interests of U.S. commerce.

In our industry's many dealings with USTR we have found that over the years the office has developed a knowledge of our industry which is useful in pursuing our objectives. This is particularly true because our industry, the U.S. tanning industry, tends to fall between the cracks of agriculture and commerce. The unique position of USTR as a part of the White House has been very effective in coordinating advice from the two departments, in addition to ours, in an effort to achieve progress in solving our trade problems.

In closing, I would like to add one note of caution. Progress will only be achieved by strengthening U.S. institutions and giving U.S. industry and agriculture a greater voice in the implementation of their policies.

The U.S. tanners would like to compete all over the world. We don't want adjustment assistance, we don't need protection. We want access.

Access takes Government negotiation. We urge you to support retaliation where it is necessary and to support reciprocity legislation. We ask you to continue to be behind the U.S. negotiators as you have been.

Chairman **GIBBONS**. I want to commend you for your very fine statement, presented extremely well.

Ms. **TALMADGE**. Thank you.

Chairman **GIBBONS**. Mr. Frenzel?

Mr. **FRENZEL**. Thank you very much. I want to thank the witness for her testimony also.

With respect to the Argentine situation, which you did not go into as carefully, because apparently you have a case in process, is it your opinion that we should renegotiate that deal? Your statement said that it worked too well, and therefore I assume that the Argentines felt they had a very unequal bargain.

Did they request that we negotiate, or did they simply turn off the agreement?

Ms. **TALMADGE**. Mr. Frenzel, I prefer to answer that question privately.

Mr. **FRENZEL**. OK.

Ms. **TALMADGE**. I can talk to you later. I just think I should not respond to that at this time.

Mr. **FRENZEL**. All right.

Let's go back to the Japanese situation.

Ms. **TALMADGE**. Yes, I can talk about the rest of the world.

Mr. **FRENZEL**. The chairman and I and others were in Japan last fall. We raised these points that you have made rather specifically, we thought. We did not make a very good—or rather, a very effective impression on the Japanese officials with whom we talked. They have raised, in addition to the complaints that you talked about, the problem that one of their aboriginal groups was heavily represented in the tanning industry, and that if they were to lose that kind of work they would not be hired for anything else.

Have they raised that question with you?

Ms. **TALMADGE**. Oh, yes. I do not mean to talk callously, but we heard about the suicide rate, the frustration, and so on.

I thought Mr. Pressler of the Department of Commerce handled that exceedingly well. He gave the unemployment rate just of the Michigan State black Americans, and that number alone exceeded the number in Japan.

I am afraid this is just a rationalization, and we are just simply ignoring that. They constantly give that as an excuse. And yet—I said that we exported about $300 million worth of leather. Actually, it was really about $280 million worth of leather. They exported about $240 million worth of leather last year. So, Japan has one of the largest tanning industries in the world. They export nearly as much as the United States. They like to portray themselves as a downtrodden, cottage industry, and in some part I think they are. But generally their larger companies are as sophisticated, as any tanning company in the world.

Mr. **Frenzel**. What kind of leather products do they export?

Ms. **Talmadge**. A lot of the pigskin, but then they are exporting the finished leather, and exotics such as water buffalo and snakeskin. Japanese exports are primarily the bovine leather.

Mr. **Frenzel**. What products do they export where they have taken American hides and worked them?

Ms. **Talmadge**. I cannot answer that about the products. My understanding is that most of the products are used domestically. I can get an answer for you. My figure has to do only with the finished leather and not the products. I will send you that figure.

[The subcommittee did not receive the information.]

Mr. **Frenzel**. Thank you very much.

Mr. Chairman, I yield back.

Chairman **Gibbons**. Ms. Talmadge, we appreciate you coming. I am sorry we did not get to hear you before lunch, and hope we did not inconvenience you.

Thank you very much.

Our last witness for the day is Alfred J. Roach, chairman of the board of TII Industries, Inc.

Mr. Roach, you want to introduce all the people that are with you there?

STATEMENT OF ALFRED J. ROACH, CHAIRMAN OF THE BOARD, TII INDUSTRIES, INC., TOA ALTA, PUERTO RICO, ACCOMPANIED BY JAMES R. GROVER, JR., COUNSEL; TIMOTHY ROACH, PRESIDENT; AND FRAN GIAMBANCO, VICE PRESIDENT

Mr. **Roach**. Yes, I will.

Gentlemen of the committee, my name is Alfred J. Roach, chairman of the board of TII Industries, a high-technology communications company whose principal office is in Puerto Rico, where I reside. I have with me my counsel, former Congressman James R. Grover, Jr., Timothy Roach, president of the company, and Fran Giambanco, vice president.

We thank you, Mr. Chairman, and the committee for permitting this appearance and the opportunity to testify in these oversight hearings on U.S. trade policy. Over four decades my business travel has taken me to Europe, the Mideast, Africa, China, Central and South America. I am aware that international trade is a highly complex field involving protocol, international law, treaties, and conventions. However, two basic situations are clear to me: The persistent lack of reciprocity abroad, and the overly restrictive and costly bureaucratic regulatory maze created or permitted by our laws at home.

The roadblocks to U.S. business and industry thrown up by some of our foreign trading partners are matters of frequent report in the press and well known to you gentlemen. Gentlemen, I had intended to prepare a comprehensive brief on this matter, but in lieu of that I wish to expand on my open letter to the President and the Congress which was published last week in the New York Times and the Washington Post. Some of the members have already read the letter, and I ask for your forbearance:

> Dear Mr. President: Not since Franklin D. Roosevelt told our nation, "The only thing we have to fear is fear itself," has fear gripped so many of our people. We Americans responded to President Roosevelt's remarks with deep faith and great determination. We built the mightiest industrial and military complex known to man, and went on to victory.
>
> Four decades ago we went to war with Japan, following "the day of infamy" at Pearl Harbor. Today we are again at war with Japan—this time an undeclared economic war—and the outlook is grim. I am not against Japan's prosperity, but I am outraged that it is they who are prospering at our expense; especially when we consider Japan's broad economic programs; organizing government, industry, labor, education and banking with the objective of full employment for the Japanese people, at the same time our government appears bent on destroying our economy. We have 9,400,000 unemployed people. Japan has virtually none.
>
> The Japanese Government is more concerned with assisting business than regulating it.
>
> Japan does not hide its strategy for winning the economic war. It is reported to us in newspapers, magazines, and on the air waves. Thank God for our free press. Without it, most of us would be unaware of the catastrophe upon us. The Japanese interviewed by Business Week, (December 14, 1981) have revealed their plan for a takeover of Western markets in the eighties.

If you have not already done so, gentlemen, I urge you to read it. "Japan's Strategy for the 1980's" in Business Week.

Gentlemen, do you have a copy of this?

Chairman GIBBONS. I have two of them.

Mr. ROACH. The American economy today does not have a chance in head-on competition with the Japanese. Why? Because the Japanese society—government, banking, labor, education—supports business, in every way. In the United States, business and labor have become the target of society—a target of our Government through archaic and repressive legislation, of a monetary policy which imposes impossible rates of interest. Some of the very policies—designed to protect American industry and consumers from unfair practices—destroy us when we deal internationally. These laws enable other countries to take our technology with impunity. This situation, coupled with the Japanese Government's subsidies and business support, puts American industry on the road to bankruptcy.

I have one example that I would like to if I may—about 6 years ago our company was involved in water purification and disinfection with Notre Dame University and we developed what was described by the man running the Chicago Sewer Department and Water Works as probably 10 years ahead of our time. Through intercession of one of the lawyers that we had working for us he recommended that we see somebody from Japan that was interested in licensing our technology. With great trepidation and fear I agreed to see them. I had not had too much luck in dealing with the Japanese.

They came over and they signed the usual nondisclosure that what they had seen they would not copy nor would they talk about. And we allowed the man to go to Notre Dame to witness it. We ran it and he was very impressed with everything he saw, fantastic technology. Then we brought him to our plant on Long Island—as a matter of fact, it was near Christmas and we were having an office or a plant Christmas party and we invited him. And at that time he had said this is just like Japan, we have the same thing with our people and he was very impressed.

The man went on back to Japan stating that he would be in touch with me in a matter of 2 or 3 weeks. A month or two went by, and finally we received a telex. We have a copy of it. It is about 3 feet long and apologizing for not having answered sooner, and stating how grateful he was with all the courtesies and so forth that were shown to him. Then he got onto what he was looking for. He said we have built what we saw at Notre Dame, and really we do not get the same results that you did. We want to know, can we come back with our engineers? I looked at my attorney that was reading it with me, I said a few words, but the only thing I said to him, just answer it yes, one word and sign it.

And they came in a matter of about 6 or 7 days. And they came in with the usual bowing and happy to see you with great presents and so forth. We put them all aside and I took out this nondisclosure when the man sat down and I said Mr. Yamasha or whatever his name was—it is in the book—do you recognize this paper, and I gave it to him. He said yes, that is me, I signed that. Yes, yes. He had an attorney with him from New York, a great big fellow. It was rather warm; he was perspiring. I said do you see it? Yes, he saw it. He said do you want me to sign another one? I said what good would that do, you signed one, it states there you will not copy it or discuss it, you told me you did do it. What good would it do me if you signed another one?

The attorney said what are you implying? That he is a crook, a liar, and a perjuror and I wouldn't do business with them. Get out of my office. The lawyer he said that is ridiculous, we will sue you for slander. I said fine. He said why did you bring him here? I said I wanted to look him in the eye when I told him he was a liar and a perjuror.

Japan, A.T. & T., and IBM—you know, I think it would be fair for somebody to say to me, Roach, at 67 years of age the chairman of about eight corporations, you sure have enough money to go around to family, friends, et cetera, why are you getting involved in this now? About 3 months ago I was called down to Washington to be a witness on A.T. & T. and the Justice Department. And gentlemen, what I saw there upset me very much. I will read what I have here.

Never would the Japanese Government have permitted the dismemberment of A.T. & T., the best communication system in the world, a company which took 100 years to build. A company, which, with its dedicated management and employees, and its technological contributions has contributed so much to the growth and greatness of America. Our Government harassed IBM in court for

13 years, causing incalculable damage, and has now found the case to be without merit. Japan would never try to cut the heart out of a successful business. If this antibusiness trend continues, our auto industry will be gone to Japan within 3 to 5 years—and gentlemen, that will affect 20 percent of the American work force—their strategy also calls for the takeover of the computer industry and communications industries in the eighties.

With A.T. & T. you have 1 million employees. You have 3 million stockholders and approximately 65 million customers. Gentlemen, I have been around the world and I know you have. You can never find a phone system that is as good as the A.T. & T. system. I recall in 1976, I believe it was, when there was a great fire in New York in the telephone system and I was in Switzerland at the time talking to some of the people in the phone business. They said it will take them a year to put that system back. Gentlemen, that system was back in a matter of hours, where they bypassed various ones. The complete system was back I believe in less than 10 days.

Now, I am a small vendor and I supply Gen Tel and Continental and A.T. & T. and many of the other independents, but if they were to ask me, Roach, can you make your tubes in the next 5 days, there is no way I could supply them. None. And I do not know any other vendor out there that could. But with the infrastructure that they have there and have built up over 100 years, they had that system back in a matter of days. There were trucks rolling within a matter of minutes.

And when I witnessed what was going on in that courthouse, I could not believe it. It was unbelievable to me that you were trying to tear apart something that was built by American people, by private investment with the cooperation of the Government, and now it seemed to me that you were taking it apart because it was successful.

The thing that is making Japan so successful is exactly what A.T. & T. has done. They have a complete infrastructure. When I mentioned about the automobile industry, in the New York Times there was an article appeared about 3 or 4 weeks ago. Do you have that? And it says new in Japan, the manless factory. In 1970, Japan made 2 million cars, 2½ million cars with 450,000 people. In 1980, they made 11 million cars with 450,000 people. Did they become that much more productive? No way. The rest were made with robots and automation. That is where your jobs have gone in Detroit.

Gentlemen, in 1985 they will make 18 million automobiles. Where are we going to sell ours unless we take some drastic action? They are not just involved in automobiles. I read an article in Fortune by Lane Kirkland. Steel plants, auto plants, railroad parts, shoes, machinery, leather, electronics, glass, rubber, aluminum—they are taking them all.

We have here Japanese education and American education. The one thing that is a big laugh to some of the engineers that I meet with is that when they graduate 1,000 engineers, they graduate 100 lawyers. When we graduate 1,000 engineers, we graduate 10,000 lawyers. I also understand there are 40,000 lawyers in all of Japan. In the United States a recent tally indicates 480,000 lawyers. How do they exist, the answer, and we need them in the corporations, government regulations, audits, reports, taxes, legislation, litigation, bankruptcies.

Gentlemen, I just went public about 3 months ago, went to the market to get some money in Wall Street. The original estimate of the lawyer to do the prospectus was $17,500 if we aborted, and on round numbers about $40,000 if we did the deal. We aborted the deal for one reason or another, because the market was not right, and I got a bill from the lawyers of how much—$125,000. We went back 4 months later with the same prospectus, a different underwriter, but the same lawyers, and their estimate of the legal bill then would be about $30,000 to $35,000 because all the work was done. I just received a bill, and how much was that? $83,000. And the excuse was, there are so many laws and rules and regulations and so forth that they have to go through with the SEC.

The public accounting firm that audits General Motors reportedly assigns a team of 1,400 accountants, spread through offices around the world, for the field work. This team alone, according to Mark Stevens in his book, "The Big Eight," is larger than 99 percent of all of the accounting firms in the world. This cost is reflected in the cost of GM cars. Japan has no such legislation.

Every Government regulation adds to every product cost. Interstate Commerce Commission rulings for 1 year alone required 57,027 pages of fine print in the Federal Register. Currently, U.S. business spends over $120 billion to complete paperwork required by the Government.

Gentlemen, it is not that I am against lawyers and accountants. I believe that their talents can be rededicated or redirected toward constructive work to help us to rebuild this Nation. You know, $120 billion to the average man or any man is an awful lot of money, but if we break it down to the individual, you could employ 12 million people at $10,000 a year or 10 million people at $12,000 a year. That is a lot of money. We would not have unemployment, we would have to look for labor.

On the other side of the coin, gentlemen, if anyone had told me a decade ago that my small company TII with annual sales of $21 million would have more pretax income than four of our largest automobile companies combined I would have laughed them out of my office. Our good fortune is due in part to the government of Puerto Rico and to our high-technology quality award-winning highly productive creative labor force. The government there has developed an enlightened policy, a tax moratorium to companies locating there to strengthen the Puerto Rican economy. As the President so eloquently told us in 1980, "These loyal Americans have proved themselves in every war since 1898"—and gentlemen, they know how to fight this one.

You may know of a little town in Toa Alta, Puerto Rico. In 1964, 30 percent of the population in that town was out of work. The Commonwealth government gave us every encouragement to locate a factory there. We began with 20 people, and now 7 years later over 450 people are working in that factory. They pay taxes, have savings accounts, buy homes and cars, American made, and send their well-fed, happy children to school.

This economic success story can be repeated throughout the United States of America. Many of our fellow Americans express a growing feeling that nothing can be done to reverse this tide, and that we will become a colonial dependency of Japan. I do not agree. Something can be done, gentlemen. Let us put partisanship aside. We must move boldly and quickly to remove from business and agriculture the restrictions and regulations that are bankrupting them. Help us to get back to where we were with free enterprise, the enterprise that built this Nation in 175 years from a backward frontier to the wealthiest and the most charitable nation in the history of mankind.

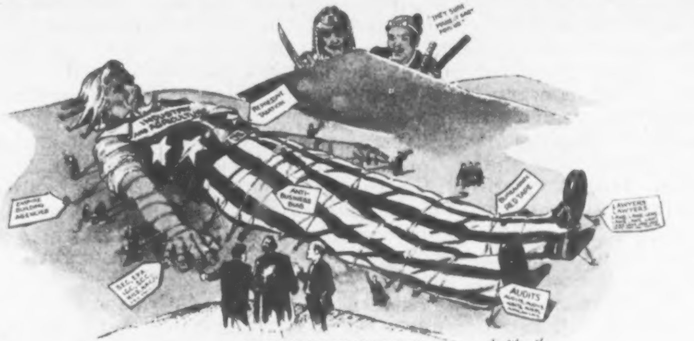
We have to trust the people. Bring us together. There are 226 million of us Americans, rich in bright intellect from every race and culture in the world who have one thing in common, the love of freedom. It is freedom which inspires creativity and productivity. Send out the call for the dollar-a-year men and women. We are still here ready, willing, and able. We have the know-how, the patriotism, and I believe we have some of the answers. We look forward to the day when government, labor, banking, industry, agriculture, and education will again work together for the full employment of our people, and I would like to close, if I may, with a quote from Lane Kirkland, the president of the AFL-CIO from the Fortune magazine dated December 14. What America needs is a fair trade policy that takes account of the real world in which free trade does not exist. No country need apologize for giving weight to its own national interest. For the United States to ignore its people, its people's needs, is suicidal in the long run.

Gentlemen, thank you for the opportunity you have given me.

[Attachments to the statement follow:]

REPRINTED FROM THE NEW YORK TIMES, SUNDAY, JANUARY 24, 1982

An urgent message to the President and the Congress of the United States of America



ONLY WE CAN FREE HIM— U.S. CONGRESS

Dear Mr. President:

FEAR!

Not since Franklin D. Roosevelt told our nation, "The only thing we have to fear is fear itself", has fear gripped so many of our people. We Americans responded to President Roosevelt's remarks with deep faith and great determination. We built the mightiest industrial and military complex known to man. And we went on to victory.

War With Japan — Then and Now

Four decades ago we went to war with Japan, following "the day of infamy" at Pearl Harbor. Today we are again at war with Japan — this time an undeclared economic war — and the outlook is grim. I am not against Japan's prosperity. But I am outraged that it is *they* who are prospering at our expense, especially when we consider Japan's broad economic programs, organizing government, industry, labor, education and banking with the objective of full employment for the Japanese people. At the same time, our Government appears bent on destroying our economy. We have nine million, four hundred thousand unemployed people. Japan has virtually none.

Japan's Strategy

Japan does not hide its strategy for winning the economic war. It is reported to us in newspapers, magazines and on the air waves. Thank God for our free press. Without it, most of us would be unaware of the catastrophe upon us. The Japanese interviewed by *Business Week* (December 14, 1981) have revealed their plan for a take-over of Western markets in the 1980's. If you have not already done so, Mr. President, we urge you and the members of Congress to read the *Business Week* article, "Japan's Strategy For The '80s".

The American Way

The American economy today does not have a chance in head-on competition with the Japanese. Why? Because the Japanese society — government, banking, labor, education — supports business, in every way. In the United States, business and labor have become the target of society — a target of our government through archaic and repressive legislation, of a monetary policy which imposes impossible rates of interest. Some of the very policies — designed to protect American industry and consumers from unfair practices — destroy us when we deal internationally. These laws enable other countries to take our technology with impunity. This situation, coupled with the Japanese Government's subsidies and business support, puts American industry on the road to bankruptcy.

Japan, AT&T, IBM and the Auto Industry

Never would the Japanese government have permitted the dismemberment of AT&T, the best communication system in the world, a company which took 100 years to build. A company, which, with its dedicated management and employees, and its technological contributions has contributed so much to the growth and greatness of America. Our government harassed IBM in court for thirteen years, causing incalculable damage, and has now found the case to be without merit. Japan would never try to cut the heart out of a successful business. If this anti-business trend continues, our auto industry will be gone to Japan within three to five years, with 20% of the American work force directly affected. Their strategy also calls for the takeover of the computer and communications industries in the '80s.

Japanese Education vs. American Education

I understand, Mr. President, that for every 1,000 engineers graduated from Japan's universities, there are 100 law school graduates. In the U.S.A., for every 1,000 engineers, there are 10,000 lawyers graduated. I also understand there are 40,000 lawyers in all of Japan. In the U.S.A., a recent tally indicates we have 480,000 lawyers. How do they exist? The answer — corporations, government regulations, audits, reports, taxes, legislation, litigation and bankruptcy. This adds great costs to our economy, eventually to products and services mounting to billions a year.

Public accounting firms (Congress legislated them into prominence by enactment of the Securities and Exchange Act in 1933-34) provide the mandated audits of corporate financial reports. In 1980, fees of only eight major accounting firms added $6 billion to the corporate cost of doing business.

The public accounting firm that audits General Motors reportedly assigns a team of 1,400 accountants, spread through offices around the world, for the field work. This team alone, according to Mark Stevens in his book, *The Big Eight*, is larger than 99 percent of all of the accounting firms in the world. This cost is reflected in the cost of GM cars. Japan has no such legislation.

Every government regulation adds to every product cost. Interstate Commerce Commission rulings for one year alone, required 57,027 pages of fine print in the Federal Register. Currently, U.S. business spends over $120 billion annually to complete paper work required by the government. It is not that I am against lawyers and accountants. I believe that their talents can be redirected toward constructive work to help us to rebuild this nation.

On The Other Side of The Coin

Mr. President, if anyone had told me a decade ago that my small company, TII, (with annual sales of $21 million) would have more pre-tax income than four of the largest automobile companies combined, I would have laughed them out of my office. Our good fortune is due in part to the government of Puerto Rico and to our high technology, "quality award" winning, highly productive and creative labor force. The government there has developed an enlightened tax policy — a tax moratorium to companies locating there — to strengthen the Puerto Rican economy. As you so eloquently told us in 1980, "These loyal Americans have proved themselves in every war since 1898", and, Mr. President, they know how to fight this one.

You may know, Mr. President, the little town of Toa Alta in Puerto Rico. In 1974, 30 percent of the population of that town was out of work. The Commonwealth Government gave us every encouragement to locate a factory there. We began with 20 people and now, seven years later, over 450 people are working in that factory. They pay taxes, have savings accounts, buy homes and cars, and send their well-fed, happy children to school. This economic success story can be repeated throughout the United States of America.

Meeting the Challenge

Many of our fellow Americans express a growing feeling that nothing can be done to reverse this tide and that we will become a colonial dependency of Japan. I do not agree. Something can be done, Mr. President. Let us put partisanship aside. We must move boldly and quickly to remove from business and agriculture the restrictions and regulations that are bankrupting them. Help us to get back to where we were with free enterprise — the enterprise that built this nation in 175 years from a backwoods frontier to the wealthiest and most charitable nation in the history of mankind. Trust the people. Bring us together. There are 226,504,825 Americans, rich in bright intellect from every race and culture in the world, who have one thing in common, the love of freedom. It is freedom which inspires creativity and productivity. Send out the call for the dollar-a-year men and women. We are still here — ready, willing and able. We have the know-how and the patriotism and I believe, we have some of the answers. We look forward to the day when government, labor, banking, industry, agriculture and education will again work together for the full employment of our people.

May I express admiration and gratitude, Mr. President, for your leadership and the cooperation you have received from our Congressmen. We need their understanding and their help in this fight for survival and the right to be free. Talk to us, Mr. President. Give us the needed inspiration and leadership. Then, God willing, the people of this once most powerful nation will waken Uncle Sam to flex his economic muscles and rise again to greatness.

With many good wishes for your health and success, I am
Respectfully yours,

Alfred J. Roach

Alfred J. Roach
Chairman of the Board
TII Industries, Inc.

If you agree with this message, please send it to your Congressman and Senator.

Publication of this letter was paid for personally by Alfred J. Roach, Puerto Rico/USA. This message may be reproduced in its entirety without permission. For information call 516-789-5076.

[From the Wall Street Journal, Jan. 4, 1982]

THE POLITICAL DIMENSION OF JAPAN'S TRADE BALANCE

(By Robert Keatley)

TOKYO.—One reason Japanese cities are so safe is the *koban*, the neigborhood police post system. And to help make the system work, people offer generous holiday gifts to their local policemen.

But on the international scale there is growing belief that Japan refuses to meet similar obligations. World-wide, the conviction spreads that the Japanese, who inhabit a true industrial superpower, extract from the noncommunist world's political, military and, above all, economic systems much more than they they put in—that, bluntly, Japan prospers from full membership but won't pay its dues.

Moreover, there's concern that Japanese politicians, despite apparent efforts to defuse antagonism, really won't do anything significant about it. Many believe the country low-profile leaders lack both the foresight and the ability to change.

Yet many Americans and Europeans contend Japan must change. They fear stronger trade retaliation against the island nation may otherwise result, damaging further the international flow of goods and services. Such moves would be designed to punish Japan but could inhibit economies of all major trading nations. This would include such developing countries as South Korea, which might see their own foreign markets dwindle as a side-effect.

Beyond that, there are political concerns. If serious trade disputes continue, diplomatic and military alliances could be weakened. This might, for example, reduce further the industrial nations' unity on such things as aiding the poor or fending off the Russians. If the West and Japan quarrel endlessly about tariffs and quotas, warns a Common Market official, this "relates indirectly to the strength of the Western Alliance and to Japanese security."

The basic problem stems from a growing trade imbalance between Japan and both the U.S. and the Common Market. The surplus with the U.S. may be $18 billion for 1981; with the Europeans it could be $11 billion. Both trade partners (but especially the Europeans) contend Japan "surges" selected goods into their markets, eliminating local jobs and creating serious political problems. And both contend Japan in return guards its own market from foreign competition by assorted means, some of them rather devious.

It is this alleged lack of reciprocity that galls Western nations most. They agree most Japanese tariffs are low and that official trade restrictions are few. But they say the system is tilted to protect businesses that can't meet world competition—such as biscuit and agrochemical makers—while liberalizing trade in those industries—such as autos—where foreigners can't compete anyway. They also contend a host of technical requirements keep out foreign pharmaceuticals, foodstuffs and equipment; although officially supposed to protect the health and safety of Japanese consumers, it's claimed their real purpose is to block imports.

Moreover, Westerners claim the archaic Japanese distribution system discriminates against them. The large markups of this multilayered network often eliminate price advantages that imports have at dockside, while big trading companies deliberately select those products that are the most Japanese, not those that are cheapest or best, when buying goods for resale.

Beyond that, the U.S. in particular has been haranguing Japan on defense issues. It claims (with decreased discretion) that Japan enjoys protection of the U.S. nuclear umbrella and a defense treaty, but won't pay its fair share of regional defense costs. It also wants Japan to provide more foreign aid as befits the industrial world's second largest (and fastest growing) economy.

Unfair, respond the Japanese. They say the country more than meets its obligations under international trade agreements—especially when compared to EEC members like France and Italy—and is taking serious steps to remove nontariff trade barriers. The military budget will increase by 7.75% next year, and Tokyo will buy more patrol aircraft as a sop to the Americans. Foreign aid is being doubled and Gaimusho (foreign ministry) officials contend their country is increasingly supportive of the Western Alliance, for example by giving extra aid to Pakistan and limiting technology exports to the USSR.

And some Japanese are being extremely peeved by all this. What the West wants, they contend, is for efficient Japan to adopt European sloth and American inefficiency. They say foreigners should work harder to meet Japanese competition and to penetrate the admittedly complex Japanese market, and stop complaining. They insist Japan won't sink to standards of the West by importing its lackadaisical labor methods, whimisical strikes and middling management.

As a recent book phrased it, the Japanese believe Europeans in particular "have lost the habit of work." Thus, tourists find Europe only a nice place to visit, with "cultural monuments, good shopping and exotic sex—all at reasonable prices and all set in elegant stagnation." Others call Europe a boutique, America a farm; beyond fashions and food, the West has little to offer that meets Japan's high standards—and that's not something for which Japan deserves blame.

A Japanese-American group is tackling the nontariff barrier issue, and partial remedies are possible in March. The leading Japanese business group is lobbying for "specific measures" to open the domestic market to more European goods. American diplomats claim that, finally, a sense of urgency exists among the rather parochial leaders of the ruling Liberal Democratic Party.

But others, including many Japanese, say Tokyo must recognize the basic problem is one of international politics, that Japan must be seen as taking dramatic action even if its solutions have more flourish than substance. (If Japan accepted all American demands, the U.S. embassy estimates the trade deficit would be cut only $800 million.) The need, it's insisted, is for Japan to be seen as determined to override political and bureaucratic objections, and to adopt effective remedies.

In other words, Japan must convince critics that it intends to be a full partner that pays its fair share of the bills. Unless that happens, warns a Western ambassador, it will be considered a nation"that derives great benefit from a system to which it contributes not enough." And retaliation, dangerous to the trade and security of all, could result.

[From the San Juan Star, Jan. 24, 1982]

INDUSTRIALIST DECLARES WAR ON JAPAN

(By Alan Patureau)

Alfred J. Roach, who brought TII Industries to Toa Alta in 1975 and built it into a thriving telecommunications equipment plant with 453 workers, is hopping mad.

The 67-year-old millionaire industrialist is "outraged" at what he perceives as the step-by-step destruction of the U.S. economy by less-than-ethical Japanese competition and self-defeating overregulation by the U.S. government.

And when Roach gets mad, this plucky Irish-American who was welterweight champion of the Army and Navy in 1934–35 responds with action.

In this case, Roach plunked down $56,000 for full-page ads in today's New York Times and Monday's Washington Post to send an open "urgent message" to President Reagan and Congress.

He urges the U.S. leaders to "move boldly and quickly" to reverse the Japanese industrial tide, "otherwise we will wind up as a colonial dependency of Japan."

He says that, almost four decades after the U.S. defeated the Japanese militarily, "today we are again at war with Japan—this time an undeclared economic war—and the outlook is grim."

Roach also injects a fat plug for Puerto Rico, extolling the local work force for its "productivity, creativity and loyalty" and the Commonwealth government for its "enlightened tax policy." In this case that means a 15-year, 100 percent exemption grant.

"Mr. President," Roach says in the ad, "if anyone had told me a decade ago that my small company, TII, with annual sales of $21 million would have more pre-tax income than four of the largest automobile companies combined, I would have laughed them out of my office . . ."

But that is exactly what happened in 1981, Roach told The STAR Thursday in a free-wheeling interview, as TII chalked up $2.3 million in profits while, of course, GM, Ford, Chrysler and American Motors recorded huge losses.

"No wonder the Japanese are winning the economic war," Roach said. "They have a small army of people at work in the U.S.—four floors in New York's Pan Am Building alone—photocopying technical journals, SEC reports, speeches and sending all of our inventions to Japan.

"In Japan, they put their workers, 66 percent of whom are sub-standard paid labor, to copying our computers, electrical appliances, scientific instruments, machinery, motors, planes, automobiles, you name it——

"I'm not out to get the Japanese, just to protect the U.S. When I was on Corregidor in the U.S. Army in 1935, the Japanese would come drifting by in their little boats to snap pictures of our installations. I'd spray warning shots with my machine gun in the water in front of them. It was against orders, but it's the only thing they would understand. I don't think they have words for charity and mercy in their language."

Roach said the Japanese have been trying for 10 years to copy TII's main products, "surge arresters" that are used in telephones, computers and satellites to protect highly sophisticated equipment by grounding sudden voltage "spikes."

The 1-to-2-inch arresters are made of ceramics and steel with a special gas inside. TII now ships two or three 12,000-pound truck container-loads daily of the arresters, plastic housings, "failsafe" tubes, plug-in circuit protectors and other devices to such big contractors as AT&T, Continental Telephone and IBM.

Roach said he recently signed a $125 million, 10-year contract to supply AT&T, and the giant telephone manufacturing firm advanced TII $8 million to buy equipment.

"I refuse to divulge the details of how I manufacture my products. Many of the reports we are forced to submit under government regulations are picked up by the Japanese in our 10K's, annual reports and many other documents deemed as public information. I know the Japanese will microfilm everything," Roach said.

"They might produce cheaper surge arresters, but they won't be of reliable, top-quality like the ones needed in today's space and atomic age. We've cut a niche for ourselves in this business, and everybody needs the widget we make.

"I challenge the Japanese with their sub-standard slave labor to match my Puerto Rican workers any day. Look at them—proud, happy, buying homes, cars—American models—sending their kids to school, exercising in our fully equipped gymnasium. We are building a nursery for the working mothers with the cooperation of Fomento."

As Roach bounded through a tour of the plant, he shook hands, clasped backs, hugged and kissed employees. "Look at the smiling faces and the gleam in their eyes when they see me," he remarked. "That doesn't come easy, you have to earn it, and it took me years.

"Recession? I told my people if we could make a product that's top-quality, competitive and on-time, we could become the largest telecommunications plant in Puerto Rico, and that's what we have done."

Roach rented the old Curtis Mathis TV plant, which had folded with 500 jobs, and TII has since expanded several times at the Toa Alta site.

In 1976 he was awarded a plaque by Fomento for his "personal contribution to the economic development of Puerto Rico," including participation in a series of agency ads for the U.S. media.

The second angle that Roach hits hard in his New York Times "urgent message" today is the overregulation of U.S. business by the government and the "blizzard of paperwork" which he claims keeps U.S. products from being competitive in the world market.

"All of the needless regulations and red tape $120 billion a year," Roach asserted. "If we could do away with that, we could create 10 million additional jobs at $12,000 a year. We'd not only solve unemployment, we'd have to import workers."

Roach declared that for every 1,000 engineers graduated from Japanese universities, there are 100 law graduates; in the U.S., for every 1,000 engineers there are 10,000 lawyers.

"We have 480,000 lawyers to Japan's 40,000. How do they exist? The answer—corporations, government regulations, audits, reports, taxes, legislation, litigation and bankruptcy.

"In 1980, fees of only eight major accounting firms added $6 billion to the cost of doing corporate business. The public accounting firm that audits General Motors reportedly assigns a team of 1,400 accountants spread in offices around the world for field work."

Roach said, "No wonder GM cars cost $1,500 more than their Japanese counterparts. Japan has no SEC laws that order $6 billion worth of audits of financial reports!"

Roach said he hopes every resident of the U.S. and Puerto Rico who agrees with his arguments will write to the president or a legislative representative and demand action.

"If this Congress won't do it, throw the rascals out. We still have the greatest society on the face of the earth. After World War II we had a guilty conscience; we were too big, too rich, so we gave everything to our enemies. Now that our economy is being driven into the ground, who will help us?" Roach said.

"We'll have to do it. It will take a miracle of cooperation from government, business and labor. But it can be done."

Chairman **Gibbons**. We thank you, sir. Could you enlighten the committee? What kind of products do you make in Puerto Rico?

Mr. **Roach**. We make what are called surge protectors for electronic equipment such as computers and telephone equipment. They protect it from lightning and also surges that may come through the power lines. And gentlemen, there are lots of surges coming through the power line, because what is happening now, we do not have enough power in many parts of the country, because it has been delayed and delayed and delayed on building sufficient powerplants, and now we have what are known as brownouts and all kinds of spikes and so forth coming through your power, and you have lots of power trouble. If I may, I would like that computer, if you have a copy there, just read that. Do you have that?

Chairman **Gibbons**. Let me ask you another question. Do you sell your antisurge equipment on the world market, or just in the U.S. market?

Mr. **Roach**. We sell it on the world market. As a matter of fact, we manufacture for L. M. Erickson exclusively. They came to us about 4 or 5 years ago and the fellow called me up and said, "Roach, I think you have developed an expertise that is better than ours, and I do not see why you do not make it for us, too." L. M. Erickson in Sweden, and they distribute worldwide for us.

Chairman **Gibbons**. Do you sell in the Japanese market?

Mr. **Roach**. I have tried and tried and tried and I gave up. I cannot sell to them.

Chairman **Gibbons**. What is the trouble?

Mr. **Roach**. Well, about 5 or 6 years ago we gave 50 tubes to one of our people in the United States that wanted to look at them with the idea that we were going to supply them, a manufacturing man, and about 3 or 4 months later, going to a convention for the Independent Telephone Association, we saw our tubes exactly made in Japan. They even kept my initials on there, AJR. They thought it was some sort of a code. They had AJR still on there. The one thing they cannot copy though is the magic formula with the gases and the vacuums and so forth. I am not belittling them. These are very well-trained people, but they are not 9 feet tall. I have engineers that I will put up $10,000, $15,000, $100,000, and I will match them against them any time for creativity and productivity.

We just issued a recent report here. This is dated January 29, 1982, Friday. TII Industries reports its second quarter for the fiscal half, sales up 13 percent, our earnings went up 63 percent. They do not tell me that we do not know how to produce and we do not know how to create. That is a bunch of bunk. What they do have and the reason they have a higher productivity is they put robots in and they put automation in, and it supplants the men.

You have in Japan two classes of labor. You have the highly skilled that go to the universities and get their degrees, and you have the high school technicians, and then you have what is known as the subcontracting labor.

Now, the first two, they work from 24 or 25 to 55, and they are forced to retire. They have no pension. They have no social security. They get anywhere from 3 to 6 years' pay, and that is it. If the 5 or 6 percent that they get from their post office on interest is not enough, they are told to live with their oldest son. That is why I keep him here. I may have to go back to him some day. And the subcontracting labor, it does not get any benefits. They have no workmen's compensation. They have no social security. They have no hospitalization. And they get paid only when they work. That is 65 percent of your labor force in Japan.

I will tell you one thing they have. They can go to Hollywood and out-Hollywood better than Hollywood ever did on their propaganda about how great their production is and their creativity and so forth. I do not buy it. I invite any of you to come down and see the plants that we have, and I have run plants all over the country. I was president and chairman of the board of Iroquois Industries in Buffalo back in 1962. I was general manager of a stock exchange firm, Edwards & Hanley in New York. We built it from 1 office to 12 offices, from 5 men to 350 men. I have found labor in this country and I will compare it with any country in the world. Why? They are free men. They are free men, and that is where you get creativity. That is where you get production.

Chairman GIBBONS. Why do we pay our lawyers so much more than we pay our engineers?

Mr. ROACH. I do not pay mine. Jim works very reasonable. I believe it is the paperwork. I believe it is the hours and hours and hours. We have something here in business the UPI, Washington, dated January 12. Seven steel firms use tons of paper to file complaints. They used 3 million pages of complaints. Three million pages—that is why you pay them. That is why you pay them. There are so many other things that lawyers could be involved in, but in order to survive we have to comply with all these rules and regulations. If you do not, you aren't going to go in business. You are not going to be able to do anything.

Predatory pricing in Japan. Here is "Smith-Corona wages a lonely battle."

Gentlemen, that is the last typewriter company in the country, right here. Predatory pricing. They are selling it for less than it costs for the steel they are putting in there. They have come back again to me about a week ago. But I will tell you, I think sometimes it pays to publicize, because I was notified 3 days ago that they withdrew their product, and the way they were trying to sell it was "We can sell it, we have found a way to get around the TII patents, and we can sell it to you for 30 percent less than TII."

The man looked at him and said, "Wait a minute, you have not asked me how much they charge."

"It does not matter, whatever it is, we will sell it for 30 percent less."

That is the kind of thing you are fighting. But I come from the street, and I know how to fight like that. But there is a lot of our people around, they don't really know how to fight like that. I don't mind fighting them. I know how to holler, I know how to scream, and I know how to go after them.

I will take a full-page ad out again, and I will say exactly what they are doing whenever they do it. It does not bother me. The good glare of publicity always makes rats run for the cellar, wherever.

Chairman GIBBONS. Mr. Frenzel?

Mr. FRENZEL. Mr. Chairman, I have no questions. I want to thank the witness for his splendid testimony, and for his good judgment in selecting our ex-colleague, Jim Grover, as his attorney.

Chairman GIBBONS. Mr. Bailey?

Mr. BAILEY. Thank you, Mr. Chairman.

I love it. What can I say?

If you think you had a jump on some of my ideas before you got here, I have news for you. I really enjoy, I think more than anything else, the intense pride that you voice and that you obviously have.

I would like to seriously ask you some questions about a number of things that you alluded to.

Are you aware, of course, that in all likelihood the things that made Puerto Rico attractive, part of the things that probably made Puerto Rico attractive were specific acts of legislation or specific Federal Government policies?

Mr. ROACH. Yes, sir. I was involved in Operation Bootstrap, and I have been given the word by the Puerto Rican government back in 1955.

Mr. BAILEY. OK. Let's take that premise.

There is no reason to go into details on it. But let's just take that fact. Let's go back over to Japan where you had the market entry problem that you had, and a number of different companies—this is a constant story that we hear. Why we don't listen to it as a government I do not know, but we are slowly beginning as a people to become more and more angry in this country.

I feel very much like you do. I get a terrible sense of indignation, anger and frustration at those people that victimize you, they use you. It is sort of a bad faith kind of a thing.

But let's compare the two societies, because I really do not think you want this country to function the way Japan does. And I really do not think that in time, as Japan's society evolves, that things are going to stay the way that they are.

But some common ground has to be found between the two countries on the relationship, the role, between those big three things that you mentioned, labor, government, and industry.

What did you bump into when you went to Japan and tried to sell your products?

I have just been involved, for example, with a company that sells a product very much like yours—some resistance type of equipment on a switch, where the Japanese came in and made an offer in Taiwan that did exactly what you said. They said "We do not care what they want to sell it for, we will meet the price and we will give you a cheaper finance package."

And I have been involved in correspondence with the Taiwanese Government on this thing. They have reopened bids because of some of my activity, because the thing apparently was unfair, especially considering the fact that the American equipment—and I have this down in black and white, incidentally—that the American equipment was superior and actually met the specifications of the contracts, that the Japanese equipment did not.

So you must have gone over there with a better product, and wanted to sell it to somebody.

What happened to you?

Mr. **Roach**. Well, Mr. Bailey, you are not going to break through. If they have any capability at all of making it, they are going to make it. Under their Ministry of International Trade and Industry, this was started back in 1952. You are not dealing against one company. You are dealing against a complete society that has gotten together with their banks, with the government, with industry, with labor, with science and education. This is what you are fighting. And they will not let you in.

Mr. **Bailey**. Mr. Roach, could I ask one thing here? There is a very important difference.

Many of the complaints that we get, or that come from the Japanese side, is that the society itself, the consumers themselves are prejudiced against foreign products. Now that is a very hard thing for any country to educate its people away from. But you obviously do not deal with a product that we are really talking about picking up in the 5 and 10. So that excuse is not going to hold in your case, I do not imagine. You are talking about a coordinated resistance, then, against your efforts to try and sell there.

Mr. **Roach**. Mr. Bailey, if you will bear with me, in Fortune magazine, on December 14, 1981, Mr. C. G. Setsumi, who carried a picket sign back when Eisenhower was President, is now the head of one of the largest combines in Japan, 8.8 billion, wanted to hire 20 people. He employs 68,000 people. He wanted to hire 20 people that knew how to speak Japanese, from France, Germany, Italy.

His announcement prompted stern warnings by immigration officials not to hire foreigners for any job a Japanese might do.

You are not going to break through that.

If we got every point that we are looking for right now, that they will give you right now, you are talking about $800 million. That is a drop in the bucket. That is not anything. They will buy cookies and candy from you, from England, and they will buy anything they cannot make over there from you, but they are not going to come through on it.

What I say is, I am not concerned about Japan. My concern here is, let us get together and rebuild our industry.

Mr. **Bailey**. I agree with you.

Mr. **Roach**. And then compete. I do not care what Japan did. And we will compete with them.

Mr. **Bailey**. I agree with you very, very much. I just hope that in the process of saying the things that you do, it is very important that we do not—because I really do not think you do, I do not think you basically would recommend that we do things exactly like the Japanese do.

Mr. **Roach**. I do not want to do that.

Mr. **Bailey**. Do not get excited. I know you do not.

Mr. **Roach**. I like their kimonos.

Mr. **Bailey**. I think you are right about deregulating this economy. I think we need changes in tax codes. I think we need changes in our trade policy. I think we need to understand the nature of what is going on worldwide or we are not going to be able to compete. But I also think we are going to need to take a firm hand against the kind of targeting that Japan does as a nation.

I hope we do not overreact to the point where we develop policies like that, because that is really not in the best interests of what you affectionately refer to and I also happen to affectionately refer to when the occasion calls for it as free enterprise.

You do not want, I do not think, the kind of tax structure they have there. I also do not think people would stand for some of the policies that the Japanese have today in their country. That will change in time.

I thank you very much for the remarks that you have made. I appreciate very much the feelings that you have voiced here.

Mr. **Roach**. The research we have done is available to your staff.

Mr. **Bailey**. We have an awful lot here, too. It just does not get out. We have about 3 million pages, as you said there.

Chairman **Gibbons**. Mr. Roach, we appreciate the substance and the spirit of your testimony.

Like Mr. Frenzel, I knew Mr. Grover when he was here. You picked a very fine man to help you. We appreciate the good judgment you have exercised there. We will try to help solve what are our mutual problems in trade.

This concludes our hearing for today. We will resume again tomorrow morning at 9:30 in this same room.

[Whereupon, at 2:40 p.m., the subcommittee adjourned, to reconvene at 9:30 a.m., Tuesday, February 2, 1982.]

U.S. TRADE POLICY

TUESDAY, FEBRUARY 2, 1982

House of Representatives,
Committee on Ways and Means,
Subcommittee on Trade,
Washington, D.C.

The subcommittee met at 9:30 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Sam M. Gibbons (chairman of the subcommittee) presiding.

Chairman Gibbons. Good morning, ladies and gentlemen.

I wonder if we could get started? Our first witness this morning in the continuation of these oversight hearings is Mr. Paul Haluza, the special assistant to the president for governmental affairs of the Motor and Equipment Manufacturers Association.

STATEMENT OF PAUL HALUZA, DIRECTOR OF GOVERNMENT RELATIONS AND PUBLIC AFFAIRS, MOTOR AND EQUIPMENT MANUFACTURERS ASSOCIATION, ACCOMPANIED BY JOHN CREAMER, STUDENT, UNIVERSITY OF MARYLAND

Mr. Haluza. Good morning, Mr. Chairman, members of the subcommittee.

My name is Paul Haluza. To change that title I am director of government relations and public affairs for the Motor and Equipment Manufacturers Association.

With me is a student from the University of Maryland, John Creamer, who is majoring in international trade and has been working with MEMA as an intern.

Chairman Gibbons. We are glad to have him here. We need a lot of new people in that area.

Mr. Haluza. Interestingly enough, he is also specializing in Japanese trade.

Chairman Gibbons. Good.

Mr. Haluza. MEMA President William A. Raftery asked me to express his personal regrets that he could not be here this morning, but he also wanted to assure the subcommittee of his personal interest in the issues that encompass international trade and world competitiveness of the domestic auto industry.

I can assure you that he is closely following these hearings, the proposals being made, and what action the Subcommittee on Trade will recommend.

Last week an Associated Press story reported, and I quote, "The number of American auto workers on indefinite layoff rose again this week to 243,500 from 229,275 last week, and planned car production by domestic auto makers dropped in the same period by 11 percent according to industry reports released today, January 28, 1982.

"The companies also said they had 80,175 workers on temporary layoff, up from 43,800 a week ago."

We are all sadly aware of these figures. Unfortunately, these statistics receive widespread publicity, but fail to tell the whole story because the numbers do not consider the ripple effect on those who depend upon a healthy domestic auto market.

Let me relate these current figures to the overall market. For every auto worker laid off by auto makers, there are at least two additional workers on unemployment from those manufacturers who supply materials and parts for the domestic auto manufacturers.

So we are no longer talking about 320,000 auto workers unemployed, but close to 1 million, and even that number could be very low if we were to include those out of work at new car dealerships, auto parts distribution and sales, and the auto service and repair industries.

Some industry estimates put the ratio at closer to five to one.

Perhaps this best exemplifies our concerns, and why we need to restore a competitive marketplace for domestic autos.

The Motor and Equipment Manufacturers Association is the national association that represents the interests of more than 750 U.S. manufacturing concerns who build components for the domestic automobile and truck manufacturers, and replacement parts and related supplies for the aftermarket and service repair industry.

That segment of the automotive industry which we represent produces virtually every product contained in a new motor vehicle or used for their maintenance.

About 65 percent of our member companies build parts for domestic auto and truck manufacturers. About 5 percent of these firms sell only original equipment while the others try and balance their sales between OE and replacement parts sales.

In 1980, the Productivity Center of the Illinois Institute of Technology concluded that the future success of the domestic auto industry was dependent upon the innovative technology of its suppliers. This means MEMA's manufacturers hold the key to the future, but, unless there is a viable market for a company to regain its initial investment, there is no economic incentive for investment in new technology.

I do not subscribe to the theory that the domestic auto industry's problems today were solely caused by its failure to meet consumer demands for more fuel efficient cars.

Certainly fuel economy has been a factor, but this has been preceded by a long period of erosion of public confidence in the ability of Detroit to do anything right.

I believe it is important to review some of the past in order to understand the auto indutry's problems of today.

I do this also to establish a rationale for some of the proposals or suggestions we will be making this morning.

No nation has a more automobile-oriented society than we do. Today our entire social structure is designed around the availability of affordable personal transportation.

This structure has been sharply criticized and the question we might ask ourselves is, does public policy support further growth of the automotive market?

Before the consumer revolution of the late sixties and seventies, there was a different approach to selling cars that was largely dictated by the tastes of Detroit designers and engineers. Domestic cars were known for their frequent styling changes and model name changes.

Mass production, availability of service and parts and affordable prices built the domestic auto industry.

I think we all can remember the excitement and public attention surrounding new car introductions every fall. Power, comfort, and glamour were the primary marketing tools for Detroit that developed customers who just had to own the newest model because of the new car status symbol.

Today a different set of standards dictates our choices in cars, and with many requirements set in place by law, a different set of priorities also directs those who design and engineer automobiles.

Most of these changes have been brought about by the influence of consumer and environmental advocates, accelerated by the energy crisis.

Concern for highway safety led to motor vehicle safety standards.

Protecting public health from air pollution led to motor vehicle emission standards.

Fuel economy requirements came as a result of the Arab Oil Embargo of 1974.

Finally, safety and consumer advocates were successful in having government establish criteria for motor vehicle crashworthiness, damageability, and repairability.

During this decade to force development of socially acceptable automobiles and light trucks, the highly visible consumer advocates and many government officials, I might add, used the domestic auto industry as the scapegoat, while extolling the achievements of the foreign manufacturers.

Before going on, I would like to make it very clear that I am not here today to pass judgment on the merits of the current standards governing automotive design, but only to review the enormous requirements placed upon our domestic auto industry and to better recognize the technological achievements it has made toward those objectives.

Today I believe our domestic auto industry has turned the corner and should be recognized for their achievements that have far outstripped their foreign competition to meet the societal objectives placed upon them.

The question is, what can be done to help restore the economic health to the auto industry?

While we have not assumed a position as yet, I do not believe the members of MEMA will support either import restrictions or domestic content requirements. We feel either of these are at best short term solutions, and that such an approach is likely to give rise to charges of GATT violations with the possibility of retaliation by our trading partners.

Further, there is no conclusive evidence that either of these proposals would provide incentives for consumers to buy domestic cars.

MEMA is ready to support progressive legislation designed to take positive steps to expand our trading presence, not restrict others.

Therefore, we continue to support legislative efforts to revise the Foreign Corrupt Practices Act, and to establish strong export trading companies.

We also support continuing review of major legislation regulating motor vehicles passed during the height of the consumer movement to insure that excessive burdens are not placed upon auto manufacturers as a result of this unforeseen and dramatic downshift in our economic and trade situation.

We have also joined with the National Association of Manufacturers and others, calling upon the administration to vigorously defend Domestic International Sales Corporation [DISC] in the GATT until such time as a suitable alternative can be found.

However, these policies only solve a portion of our trade problems. I would like to explore two more issues.

First, MEMA strongly supports the concept of free trade, but only when free trade in the United States is reciprocated by our trading partners.

Unilateral actions by the United States will do little to open the ports of other countries.

However, we believe the U.S. Government should impress upon our trading partners the importance of permitting access to their markets and removing nontariff barriers against U.S. products.

I would like to point out that in the fall of 1978 MEMA led the motor vehicle components section of the U.S. trade mission to Japan. We felt at that time that the mission would at the very least provide U.S. manufacturers with the opportunity to supply Japanese vehicle producers with some original equipment and replacement parts for vehicles sold in this country. In 1980, MEMA president, Bill Raftery, stated before this very subcommittee that no substantial progress had yet been reported by the participants in that mission.

Two years later we regret to inform you the situation is no better, and considering the increased competition from Japanese imports, it is in fact getting worse.

We urge the Office of the U.S. Trade Representative and the International Trade Administration to accelerate their efforts toward removal of nontariff barriers, especially in Japan.

Second, together with supporting actions related to improving our position in international trade, we feel that a fundamental change in consumer attitudes must also be achieved.

From the opinion polls being released, it would appear that the general public has accepted the misguided notion that American cars, parts, and workmanship are inferior.

The U.S. auto parts manufacturing industry has had to maintain technological superiority over its Japanese counterparts because American vehicle manufacturers will source their parts from anywhere in the world, unlike Japanese manufacturers who purchase parts solely from their own captive suppliers.

The motivation for American parts manufacturers is simple—sales.

Changing consumer attitudes will not come easily, nor will they come as a result of the incentives being offered by the vehicle manufacturers themselves. They are going to need a report card rating from government that recognizes the strides they have made over the past decade, and some added incentive for purchasing a new car.

The rating system we would propose would weight the difference between the point at which each vehicle manufacturer started to improve its fuel economy, safety, crashworthiness, repairability, and emission control, with what they have achieved toward these goals in 1982.

I feel strongly that a successful achievement record would favor the domestic auto industry.

Based on their ratings, I would then suggest an income tax credit to purchasers of those motor vehicles with the greatest achievements.

Tax incentives are a motivating force in this country. Just look at tax-free savings. This incentive attracted $43.3 billion to savings and loans, banks, and mutual funds during the first 3 months it was permitted.

I am also keenly aware that tax credits may be a dirty word in this era of $100 billion deficits, but if what I am proposing has any merit, Government could offer up to a $1,000 tax credit and still reflect a bottom line profit.

I call your attention to a chart that has been attached to this statement reflecting the cost to government for each unemployed autoworker.

You will note that each autoworker also removes two supplier workers from the payrolls, and their combined cost to the Federal and State governments approximates $33,300. For each 15 new American cars sold, the 3 workers are returned to the payroll.

[The information follows:]

Auto Industry Employment Relationships and Cost Figures

One job is generated in the primary manufacturing sector for every 15 autos produced.

The associated costs per 1 unemployed worker are as follows:

Lost tax revenue	$5,000
Unemployment insurance	4,400
Trade adjustment assistance	4,700
Total	14,100

In addition, each State loses $600 in tax revenue.

Two jobs are generated for every 15 autos produced in the supplier industry (includes raw materials and parts manufacturers).

The associated costs per 1 worker are as follows:

Lost tax revenue	$2,000
Unemployment insurance	3,300
Welfare, medicaid, etc.	3,750
Total	9,050

In addition, each State loses $250 in tax revenue and $50 in welfare payments.

This produces total losses between the primary and supplier sectors of 32,100 dollars for the federal level and $1,200 in State funds.

Mr. HALUZA. I believe this proposal would also send a clear message to the American public, the time for tearing down institutions has passed, now is the time to be rebuilding them.

Thank you for allowing me to appear before you this morning, and I would be happy to respond to any of your questions.

Chairman GIBBONS. Mr. Haluza, I have great sympathy for the problem you find yourself in. Let me make my position clear. I want to help in any way that does not violate our agreements that we have made.

I want to help in any way that I can. I do all that I can. I buy your cars, although I must say I do not buy many of them because the last ones I bought were so lousy it took about 50,000 miles to get them running right.

I told Mr. Cole, the president of GM the same thing. I am not talking about them behind their back. I am telling you what my experience has been. I might even add I encourage the members of my family not to buy foreign cars. I do not rent foreign cars or anything else.

I do not believe Detroit has done everything wrong. There are a few things that they have done right.

Let me just tell you though, I rented a car from Avis early last year and when I started to do a simple thing like putting the bags in the trunk, I found that every time you lifted the trunk, the rubber gasket around the trunk came off.

I figured this is just a lemon made on Monday, Friday, or something like that.

Then I kept on renting cars. I found none of the gaskets stuck on any of the cars that I rented. These were General Motors cars.

I had to have one of them towed in, a brand new car; had 10,000 or 12,000 miles on it, but relatively new.

The air-conditioning broke down on another one. This was all last year.

You know, it is great to have the air-conditioning break down in Florida on a hot summer afternoon while you are running down a dirty, dusty road, as I was, about 100 miles from home.

I kept coming and going to airports, as I have to. I always try to avoid putting things in the trunk but occasionally I did have to.

Finally, tar off the trunk got all over, down in the bottom of the trunk. It got on my bags. It got in my rugs. It got in the furniture, over my clothes and everything else.

It got so bad I finally got Avis to give me back some money for the cleaning of my clothes. These were brand new American-built cars. They were sloppy.

I wouldn't vote for a tax credit on this if my life depended on it. That has to be the silliest argument I have ever heard for productivity and what to do.

The market ought to be the test of what they do. You know, they come out with all these gimmicks about lowering the price of cars. General Motors is now cutting prices. It won't cut that crazy, fool sticker that sticks on there that nobody can make any sense out of, but you know, Detroit doesn't do everything wrong.

But, the few things it does right—and I am one irate motorist, I rent their cars. I would rather not tie my money up in the stuff they turn out but that is the kind of problem we have.

These are not just my views. If you want to strike up a discussion in this audience, go out there and get a number of those people together and say, "What do you think of the car you just bought that you are driving around?"

You are going to get more things. People will tell you about doors that almost fall off, all the other stuff they have to stick them together with.

I have watched American assembly lines. Some of them are new and modern, but essentially the car is being manufactured about the way it was 30 years ago, 40 years ago.

I have a great deal of sympathy for the industry. I want to help it, but it is going to have to help itself. It has the highest labor rate of anybody except the steel industry.

What has happened is, American steel and American cars have priced themselves out of the American market. Unless they have political muscle to get back in.

American steel is doing finally what I have been urging them to do for 7 years; that is, to go out and prove these cases about dumping and things of that sort and use the law available to them and not try to use their political clout available to them.

I hope that the American automobile industry will do that.

You say the Japanese are keeping you out of the market. How do they keep you out of their market? What does the Japanese industry do that keeps you out of their market?

Mr. HALUZA. As far as OE sales go, they have a completely different structure. They have a social structure over there that creates a family relationship. Their suppliers are virtually within the same plant as their OE. It is a closed market.

Furthermore, everything we have found is that they lean toward buying Japanese. They don't trust anybody else.

In this country it would be called a racist policy, but that is their—it is a social point in Japan.

Chairman GIBBONS. Well, I am not here to defend the Japanese. I happen to have gone through Mr. Toyoda's factory in Toyota City in September. I said, "Mr. Toyoda, where do you get your parts that you assemble from?"

He said, "Well, I get them from the local suppliers." He said, "Would you like to see my inventory?"

He had an assembly line running wide open. They were making six body styles on one assembly line, a two-door, a four-door, a station wagon, a left-hand drive car, and a right-hand drive car, all on the same assembly line.

I expected to see a warehouse full of parts. He took me in a room that wasn't much larger than this room for this huge plant that was running wide open. He had practically no parts in there.

I said, "How can you run this assembly line this fast with those few parts?"

He said, "Because we get good delivery from our suppliers."

I said, "Do you test the parts when they come in?"

He said, "No, because if they aren't perfect, if every one of them doesn't work perfect, that supplier knows we will never do business with them again."

In other words, he uses the tool of management. If your parts don't arrive on time, if your parts aren't perfect, then you don't do business with the people again.

That is not true in America that I know of. But that is the way he does it.

If that is racist—it sounds like to me it is good management.

Mr. HALUZA. Well, it is a closed market in Japan, as I understand it.

The Japanese will tend to source from long-time suppliers, people who are very close to each corporation. Toyota has their group of suppliers. It is an interrelationship that exists in that country that does not exist in the United States.

The U.S. auto manufacturers will source from any place—U.S. manufacturer will source his parts from any place. Basically it is on price.

Chairman GIBBONS. I understand—I read in the newspaper the other day the Japanese can beat us on price by about $1,500 a car. If price is so important, why are we in such bad shape?

Mr. HALUZA. I think it has been fairly well concluded, sir, that the current price difference lies in the labor costs to an American manufacturer to build a car. That is something that the auto companies and the labor unions are going to have to work out among themselves.

Chairman GIBBONS. They sure are, instead of taking it out of my hide, and all the other consumers' hides. They are going to have to work it out themselves.

I wish they would adopt that attitude and get it worked out. We could shorten these hearings a whole lot.

First, let me say I appreciate your coming. I didn't think anybody from the automobile industry was going to turn up. I haven't seen anybody from the big three. I hate to take out my feelings on you, but I appreciate your coming.

I would just appreciate somebody from the big three showing up and telling us what is wrong with their industry.

Mr. HALUZA. I think I would like to hear some of their answers, too, sir.

Chairman GIBBONS. Mr. Bailey?

Mr. BAILEY. Thank you, Mr. Chairman.

Mr. Haluza, my views are slightly different than my chairman's, with all due respect. I think I can defend and I can criticize at the same time.

I can remember where—and it doesn't do any good to mention names, an American company whose competitive watchword at one time was "quality control."

The American market being what it was, consumer habits being what they were, sales techniques and promotion techniques being what they were, that didn't do that company very much good.

If you remember back, you probably will be able to identify that company. It was one of the big three. They were well known for building the best engines, for building the best drive train, for initiating unitized body construction which were the hallmark of excellence. It didn't do them any good because the American market was not that concerned and people did not want to pay a few hundred dollars more for a car if it was going to last them 4 or 5 years.

Chairman **GIBBONS**. Excuse me. If you are talking about Chrysler, they didn't tell you that it rode like a tank and wouldn't start.

You know, I used to buy Chrysler products. I couldn't get the darned things to start. I actually had an engine on a Chrysler product blow up because it wouldn't start. That cured me.

Mr. **BAILEY**. Let me tell you——

Chairman **GIBBONS**. Their quality, I think the American consumer saw through it.

Mr. **BAILEY**. Since you said that, let me first of all say my father, who is retired now, was a truck driver. I grew up as a kid in a large family. When I was 14 years old I overhauled my first car. It was an Olds 98. There was a great big V-8 engine in that thing that I just loved as a kid. I was going to get it ready to drive.

I had a 1957 Dodge with a 318. I can criticize braking systems on that particular kind of car. I remember as far as cornering was concerned, they took a Chrysler Imperial at one time—actually took a wheel off the car—and drove it from the west coast to the east coast. Anybody remember that test? Maybe none of you do.

There was no doubt in my mind, at least at the time that the quality was there. I am not saying that is the company I am talking about, but I think you can criticize.

Geez, I can go back to that flathead straight 8 Buick in 1947, 1948 that was an oil burner. I can take any manufacturer, any particular kind of car. The 1957 Buick used to overheat a lot, used to carb up.

I had a friend when I was in law school who bought a Datsun and leaned against the fender and his hand went through the fender.

You can take any type of car and talk about it. You did mention Chrysler. They did do a great deal with quality control later on. That starter, incidentally, I never had any trouble with it. They used to have a high-speed starter.

Sometimes they would burn out. Every car had their mechanical idiosyncracies. Every car you buy anywhere in the world today does. That includes those so-called wonderful Japanese cars.

I think it has to be said the Japanese fell into a windfall. I am not going to defend everything Detroit does. If gasoline today were 36, 48 cents a gallon and the energy crisis had not occurred, I don't care what you say, you would not sell many Japanese cars in this country.

Everybody would have a nice big car. That is what we were geared toward.

I do want to say this to you: Part of the problem with America's business development, I think, has been the fact that we have been the market by and large. We developed a lot of the small car technology, incidentally, our companies did when they went abroad. They went abroad to build abroad for foreign markets.

It takes a great deal of time to retool, to recapitalize, to readjust.

Talk about windfalls and EPA standards. The Japanese fell into those also simply because of the displacement of their engines and that kind of thing—the compression ratios in their engines.

Performance, luxury, those kinds of things were American hallmarks of big cars. Quite frankly, Detroit was building exactly what the American consumer wanted.

That is just what they were doing. They cannot alone bear the burden of making the adjustment because we are paying a dollar something for a gallon of gasoline or we decided to take lead out of our gasoline.

These are good things. I suppose they are. The world is going to need this petroleum in the future.

I want to mix some criticism because I think we did languish too long. We got lazy. We got indifferent to consumers.

I don't think our customer relations were that good. I really don't.

I know an automobile dealer in the Pittsburgh area that said—in fact, I overheard the man say—it was not second or thirdhand—that he was selling something like 2,000 or 3,000 cars a year, he didn't give a damn about customer relations. He didn't expect to see that person necessarily. He wasn't going to service a car.

I think the whole system, we got a little lazy. I think the chairman is right in that regard. I think he is right on target.

I don't, however, agree with where the problem lies. I want to say I want to congratulate the industry because I think there is a tremendous effort under way right now. I am so happy to see labor and capital sitting down and starting to reappraise some of the problems today. I just hope it continues.

The country is absolutely not safe from a national security point of view without a vehicle industry. We must have an indigenous vehicle industry. We have a huge investment in plant, equipment, labor, skill, that kind of thing already.

The only thing we can do is do something about it. I will vote for those tax credits because quite frankly one of the reasons the Japanese have been able to compete so well is the fact they have effectively targeted their resources.

One need only ask why over the years since the end of the Second World War foreign automobiles even from small car technology countries and firms abroad—not from us—have never been able to penetrate the Japanese market.

There is a very good reason for that. Japan has specifically targeted; it is there in black and white. They have protected and pressured consummables—their domestic markets and consummables in their own country—to build industrial products, to enable them to enter and compete in more open markets. Quite frankly, Japanese resources and the Japanese consumer have paid for what has been a concerted national effort to assault markets in other countries.

It has been on an industry-by-industry basis. There is no question about it. I can remember when you went to the store and you bought something that said "Made in Japan," and it meant cheap, sleazy, lousy, and no good. All of us can remember that.

I was young at the time, but I remember in the fifties, if something was "Made in Japan" it was a way to say the damned thing was no good. It was a way to say it was cheap, lousy, and ineffective.

The country, and I hand it to them, did a great job on quality control. God bless them. They did the right thing.

That does not mean we as a country cannot or should not do the same thing. I think there is a governmental role. That is why I disagree with the present administration. They do it by leasing.

I would have done it in different and, I hope, in more effective ways. I do think we need to get some resources in this country diverted into basic plant and equipment to maintain an industrial base that is vital to us.

Our businessmen have to learn and learn quick. I have confidence in them.

I congratulate them for trying to adjust. I love to hear the Japanese talk because when it is all said and done, America will be there. We will win. We will do it. We have the resources, the minds, the ability.

One question now that my speech is done.

Do you feel qualified to address the issue of what has happened to foundries in America?

We used a lot of cast parts. I really doubt whether the country is going to have a sufficient reservoir in that area to meet the kind of needs we have. We have been losing that capacity. I wonder if you can talk about the problems there?

Second, are you aware of the parts agreement? You mentioned parts here with the Canadians on Volkswagen. Are you familiar with that problem?

Mr. HALUZA. Not intimately; no. On the foundry one, I would be happy to respond to your question in writing if I can find an answer, but it is really not in our particular area. We don't get into castings, but——

Mr. BAILEY. You are buying a lot of them.

Mr. HALUZA. I would be happy to get the answer. The same way with the Canadian situation. I can get the answer for you. If you don't mind, with the chairman's permission, we will submit it in writing.

[The following was subsequently received:]

IN RESPONSE TO CONGRESSMAN BAILEY'S QUESTION REGARDING THE CANADIAN-VOLKSWAGEN AGREEMENT

As we see the issue at MEMA, the Canadian government is diminishing the benefits of the Canadian Automobile Agreement with the United States by indirectly subsidizing the Canadian auto parts producers through a duty remission for cars manufactured using Canadian parts. We are concerned over this type of agreement because it represents an increasing trend where Canada (and also Mexico) are actively promoting their own parts industry to the detriment of the American industry. We feel that the government must review the Canadian Agreement in light of these new developments and that the government must also look at the practices of all our trading partners towards their domestic industries. As MEMA President William A. Raftery phrased it, "We are playing the same ballgame with a different set of rules." MEMA is also concerned over the fact that U.S. economic and commercial policies are increasingly being decided by political criteria, rather than with concern for the economic realities of the marketplace.

Mr. BAILEY. I wish you could. I think you folks ought to get on top of these things more. When you do have a right to complain, I think you ought to. I think the chairman touched on very valid criticisms. I think we have to adjust to them.

I don't think you are aware of what is going on around you. I think that we are going to have to be the folks that complain about those things so we start writing better law that will enforce some of these things.

We can't continue to be jawboned to death by the Japanese because Administrations are afraid that the Russians are going to take another island north of Japan. We have to learn to stand up for what this country needs because if this country is not strong, the whole West, the entire Free World, is not going to be strong.

We haven't learned that lesson yet. It is a little infantile in our approach to that problem. You folks had better start learning about some of these things.

Mr. HALUZA. We do have the information. It is just that I do not have it with me this morning. We are tracking this in our home office in Teaneck, N.J.

Mr. BAILEY. I would like to ask another question. No. 1, comments on the Volkswagen thing. That information came, incidentally, not from Volkswagen itself, but from the Export-Import Bank people that I got the information from.

The second thing is I would like you to comment on the flight of capital to Mexico. Mexico, Mr. Chairman, is not a member of the GATT, as I understand?

I had a problem in my home district with one of these things, taking advantage of American duties on assembly and disassembly of parts. I wish you would get into that a little more.

Mr. HALUZA. We will get you the answers. You would like to find out what our agreements are?

[The following was subequently received:]

IN RESPONSE TO CONGRESSMAN BAILEY'S QUESTION REGARDING THE SHIFT OF METAL CASTINGS TO MEXICO

Although the auto industry does use castings for parts, the manufacturers which MEMA represents are not a part of the foundry industry. Further, the major cast component on a motor vehicle is the engine block itself, which is produced directly by the vehicle manufacturer. On this basis, MEMA is not qualified to discuss the movement of casting foundries to Mexico.

Mr. BAILEY. I would like to see a little history. I think the chairman is right. In one aspect, the businessmen come down here, associations come before the committee. I find myself having to research and dig out things. I don't know if it is because you are afraid that you cannot do business, or some country is going to sit down and listen to what you say and come in and put a little heat on you or something.

I don't know. It is like pulling teeth to get information about things that privately a lot of the associations and companies complain about when doing business in other countries.

It is true, we do need that kind of information. We don't get it often enough. I have to sit here all alone dwindling—hanging in the wind on the end of a limb and I think you folks ought to bear the responsibility for talking about some of these things.

Mr. HALUZA. Mr. Bailey, if I may, I will respond to that by saying I would certainly—to any member of this committee or anybody in Congress who has specific questions on international trade issues, all they have to do is contact my office in Washington and ask the question and we will get you an answer.

Mr. BAILEY. That is what I have been doing. I would like to hear you come here and spontaneously cough it up. I tell you, if you could get some answers for me on the experiences that your clients have had with doing business in other countries, because you are reluctant many times. I am not saying you are, but many groups are that come before the committee.

They are reluctant to talk about it. They deal differently in another country. A lot of things are off the record or jawboned things and you are not protected by law. People are afraid to talk.

I had Volkswagen people in my office talking apologetically about what they had to do with the parts deal in Canada. I still can't get that much reaction out of the official community or out of the Congress or out of the President on this issue.

It is a glaring indication of what companies are up against if they want to do business in another country. If this country ever did that, they would be howling to high heaven. Trudeau would be screaming, shouting, complaining about America's imperialistic economic practices or whatever.

He probably wouldn't use that word, but he would get mighty close to it.

I think if our companies have a concern about this country, they ought to start talking about those things. Mexico is the same story. I had a letter from somebody the other day on a pipeline issue talking about why we don't just buy the gas from Mexico, why build a pipeline? Hell, because it probably would be about $7 an MCF in 2 years if we did; that is why.

Thank you very much. I hope you can answer some of those questions. Thank you for being kind with the time, Mr. Chairman.

Chairman GIBBONS. Sure.

I do have one accolade for your industry. The replacement parts I have bought from you have held up better than the original equipment on my station wagon and Chevrolet and my Camaro. The transmission went out on the station wagon at about 50,000 miles or something like that, and had to be towed in and a replacement transmission was put in. The car has 140,000-plus on it now; the replacement transmission is still going.

I don't know what you do to them when you sell the replacements that you don't do in the original, but it sure is working a lot better. The same thing on my Camaro. The transmission went out at about 50,000. The Camaro has over 100,000 on it now. It is still going strong. If you ever get them running right, they run a long time or they rust out on you; but they do run a long time if you get them running right.

I think Americans are finding out you don't need to trade in a car when the ash tray gets full and loses its new smell. I think one of the things your industry is running into—and of course in the parts business it means you get a lot more replacement parts—people are keeping the old bus a lot longer.

No longer is there the social pressure there once was on families to buy new cars every time they change the molding around on them. I think that is what we are seeing.

I appreciate your coming here. Thank you very much.

Mr. HALUZA. Mr. Chairman, I appreciate the opportunity to speak before you.

Chairman GIBBONS. The Cheese Importers of America are next. Please come forward.

Who wants to lead off?

STATEMENT OF HAROLD C. STEINKE, PRESIDENT, CHEESE IMPORTERS ASSOCIATION OF AMERICA, INC., ACCOMPANIED BY BERNARD A. TRUGMAN, FIRST VICE PRESIDENT; NEAL SCHUMAN, SECRETARY; MARVIN HAAS, DIRECTOR; AND ROBERT FROMER AND ANITA KAUFMANN, COUNSELS

Mr. STEINKE. Mr. Chairman, thank you for the opportunity to appear here today. My name is Harold Steinke. I am here as the president of the Cheese Importers Association of America. With me is Bernard A. Trugman, our first vice president, Neal Schuman, our secretary, and Marvin Haas, a director. We are accompanied by our counsel, Robert Fromer and Anita Kaufmann, members of the law firm of Hartman & Craven in New York City.

We have submitted to your committee a statement detailing our positions which we ask you to make a part of the record for consideration by the staff.

Chairman GIBBONS. Without objection, that will be done.

Mr. STEINKE. Today we will briefly summarize that statement.

We have 155 members in our Cheese Importers Association in 19 States from coast to coast. Some of our members have historical licenses dating back to the first imposition of controls on cheese imports in 1953. Others have always imported "price break" cheese and still others are new entrants to this business.

While most of us are relatively small companies in the cheese importing business, we find ourselves in a rather unique position during the most recent GATT round. Our businesses overnight became very important bargaining tools for the U.S. negotiators. We didn't particularly enjoy that role. We sort of felt like pawns in the game of negotiations between our country's representatives and others.

Since GATT, we have been regulated by new rules and we are grateful for this chance to testify and offer our suggestions for improvements to those regulations. So, we come here today with six specific recommendations. These six recommendations are in agreement with the five goals suggested by your subcommittee in 1979, which are: First, to protect traditional importers; second, protect price break importers; third, protect new entrants in the business; fourth, take measures to maximize the utilization of import quotas; and five, provide for continued competition.

So with those goals in mind, here are our six recommendations:

No. 1, eliminate the price undercutting law. This law was designed to permit anyone to complain about low import prices and puts the burden of investigation and remedial action for them on the USDA with a deadline of 30 days.

This so-called fast track procedure is nice in theory, but it is not practical. The law is a nontariff barrier, pure and simple and it should be eliminated for 10 reasons which we have detailed in our formal statement.

Briefly, those reasons include the fact that we already have quotas to protect domestic industry; unlike many countries, the United States does not have an official price for cheese; the law can result in the collection of a double-duty when cheese is imported; foreign currency valuations are a fact of life today; we have a working countervailing duty law; and this law to which we object contains something called the domestic wholesale price of cheese as a benchmark and there simply is no such thing in the United States.

That phrase is a creation of Government which does not exist in the marketplace.

This law has become a maze of unnecessary and burdensome regulations which we could very well do without.

Therefore, Mr. Chairman, we recommend that this law be eliminated so that our quotas may be more fully utilized in a truly competitive fashion.

Suggestion No. 2 is the institution of a fair and flexible system for transferring licenses from one country to another.

Now, the USDA may authorize an importer to transfer his license only if cheese from a particular country is unavailable. The USDA determines whether the cheese is available after lengthy consultation with the foreign country.

Therefore, the word "availability" is key.

In the past, if cheese was available at all in a country, the USDA erroneously said it was available even though the quantity, the quality, the style, the packaging, the size and the price may have made it useless to us as importers.

The best measure of availability, we feel, is the actual purchase and trade in the imported cheese. Therefore, we recommend that the USDA be allowed to determine unavailability when a low percentage of cheese is being imported.

This recommendation will eliminate the unfairness of subjecting our importers to the whims of foreign countries which usually wait until close to the end of a quota year before declaring that cheese is not available.

Then when importers finally receive a transfer of their license, there is not enough time to get it purchased, shipped by sea, and imported before the end of the quota year and they become liable for a harsh penalty the following year.

The trigger mechanism which we outline in our formal statement would maximize the utilization of quotas in a real competitive atmosphere. It would make the transfer of licenses an American decision rather than a foreign one.

It will reduce redtape and paperwork both for the importers and the USDA. It eliminates the ambiguity of language in the regulation of which examples are "proof positive," and "special factors." Most important of all, it will not affect the original quotas for the exporting country.

Suggestion No. 3, eliminate the preferred importer's status. Preferred importer status allows a foreign government to designate the U.S. importer of its choice to receive a USDA license to import its cheese. This regulation was not the result of any international negotiation, but it was only a product of USDA regulation.

We as cheese importers were aghast when this regulation was promulgated. We think it represents blatant favoritism not codified by law. It is political payoff, it is nepotism. We U.S. importers worked very hard to build a market for certain cheeses.

That market should not have been taken away from us and given to foreign entities, either government or private, after the quotas were imposed.

In asking you to eliminate this provision of law, the CIAA hopes to protect business development in this country and provide cheese licenses for new importers. We hope to discourage foreign entities from forming U.S. subsidiaries whose only purpose is to exploit the gift of this business from our Government.

We hope to restore the incentive for importers to earn profits in this country and pay taxes here rather than abroad. We hope to restore the right of the Department of Agriculture to carefully select licensees according to American criteria for eligibility.

Mr. Chairman, the preferred importer status is an un-American concept. It discourages free competition. It should be abolished to give new entrants and price break importers a chance to participate along with the traditional importers in what is already a restricted volume business.

Suggestion No. 4. The United States should allow the importation of 2,000 tons of cheese that has not yet been licensed. Our law authorizes an annual importation quota of 111,000 tons, but licenses are only issued for 109,000.

We are told the United States held back 2,000 tons of cheese as a bargaining tool to gain concessions for agricultural exports. Now, after 2 years, neither the United States nor other countries have gained anything from the nonutilization of the licenses.

In fact, our cheese importers are the only ones who have suffered. By denying these 2,000 tons, new entrants to the import business as well as historical importers cannot fully maximize the negotiated quota.

Suggestion No. 5. Is to combine natural cheese and processed cheese licenses for the same varieties. For obscure reasons surely no longer appropriate, three of our import quotas specifically combine natural and processed cheeses while three others specifically divide them.

We think this inconsistency should be corrected. Whether in its natural form or processed form, any given cheese variety is basically the same kind of cheese. This combination would encourage this committee's desire to maximize the use of quotas.

Our final suggestion, our sixth suggestion, is that import quotas should be increased. Few if indeed any American businesses are saddled with a government restriction that places an absolute lid on growth. It works against everyone's desire to expand the U.S. economy and to increase our living standards.

Now that cheeses are under import quota, we are denied the opportunity to grow unless another sector of the U.S. economy needs a favor abroad. Then our Government might increase quotas to obtain the favor.

We are not asking for an unlimited growth opportunity like other businesses have, but we think that a formula which would provide for an annual increase in accordance with cheese consumption, or with the growth of population, is only fair.

It should be noted that our delegates agreed at Geneva to review as early as next year the existing amounts of our cheese quotas. We submit this agreement was made with the realization that the existing quotas contained no provision for growth.

Such an increase would help preserve competition as was suggested in your 1979 report.

Summarizing, Mr. Chairman, we believe that our six suggestions are reasonable, equitable, workable, and in keeping with the views expressed by this committee in 1979. We respectfully request that the report which results from these hearings ask for implementation of our suggestions. Thank you for this opportunity to appear and present our views.

[The prepared statement follows:]

Statement of Cheese Importers Association of America, Inc.

This statement is submitted on behalf of the Cheese Importers Association of America, Inc. in connection with the oversight hearings on U.S. trade policy, including policy objectives, development, coordination and administration; administration and adeqaucy of U.S. trade laws; trade agreements policy, implementation, and enforcement; and specific trade policy issues.

The Cheese Importers Association of America, Inc. (the "Association") is a nonprofit trade association formed approximately 40 years ago whose membership is comprised of the majority of firms engaged in the business of importing, promoting, selling, distributing and transporting cheese and cheese products in the United States.

Our members now operate under regulations (7 C.F.R. §6) promulgated following the Trade Agreement Act of 1979. The importance of U.S. cheese imports to the negotiating strength of the Special Trade Representative during the most recent round of the General Agreement on Tariffs and Trade (GATT) was evident. We are proud to have made this contribution to the overall settlement. Generally, the new import regulations have operated well.

However, our members are painfully aware of the stifling effect that some of the provisions have had on our businesses. In order to eliminate or reduce inequities and hardships which exist under the present system, our Association advocates six (6) modifications of and improvements in the import regulations.

Our recommendations will allow the regulations to fulfill the commitment articulated by the House Ways and Means Committee in its report on the Trade Agreement Act:

[W]ith the expansion of the quota to cover both old quota and old price-break cheeses, care must be taken by the United States Department of Agriculture to allocate new license rights so as to protect both the rights of those who have traditionally been in the business of importing quota cheese and the rights of pricebreak cheese importers who have had no historical record of holding licenses, as well as new entrants to the cheese importing business. Care must also be given to fulfill the provision in a number of agreements that "the United States agrees to take all necessary measures to permit the maximum utilization of quotas" . . . . Th[is] Committee . . . expect[s] the Department [of Agriculture] to provide for a fair allocation of rights to import. Within the overall quota system, competition must be provided in the importing, wholesaling and retailing of imported cheeses. Trade Agreements Act of 1979, Report to House, Ways and Means Committee To Accompany H.R. 4537, p. 138 (July 3, 1979).

The improvements are designed to protect the rights of three groups of importers:

(a) historical licensees,
(b) "price-break" importers and
(c) new entrants to the industry.

Licensees traditionally in the business of importing cheese have had difficulty filling their quotas because of unfair regulations. All licensees will be better protected if the government:

I. Eliminates the price-undercutting law; and
II. Implements a trigger mechanism for the transfer of licenses.

Price-break importers are those who traditionally imported expensive specialty cheeses which were outside the quota and licensing system prior to 1980. Thus, they had no historical record of holding licenses for their price-break cheeses. Price-break importers and new entrants to the industry are dissatisfied because current regulations and policies discourage new entrants, deprive importers of a certain portion of their former price-break cheese imports, fail to allocate all authorized licenses, impact unduly harshly on importers due to unyielding formula provisions and gratuitously "give away" one-third of earned American import licenses to foreign governments. Price-break importers as well as new entrants will be better protected if the government:

III. Eliminates the prefered importer provisions; and
IV. Allots the 2,000 tons of authorized but unallocated licenses.

Finally, all cheese importers suffer from an inability to grow and to maximize the utilization of their licenses. Cheese importers will be better protected if the government:

V. Combines natural and processed cheese licenses; and
VI. Increases quotas.

I. THE PRICE-UNDERCUTTING LAW SHOULD BE ELIMINATED

Section 702 of the Trade Agreements Act of 1979 provides a unique "fast track" process to safeguard the domestic cheese industry from imports of subsidized quota cheeses that undercut the United States wholesale price for similar domestically produced cheeses. However, the price-undercutting provision has proven itself unwieldly. The law subjects imported cheeses to "double jeopardy", represents costly and unnecessarily burdensome government regulation, contributes to expensive compliance problems due to its ambiguity, provides too little time for the Department of Agriculture to study the determining factors and leads to the underutilization of licenses. The Association therefore recommends the elimination of the price-undercutting law.

The "fast track" process can be summarized briefly. Any person who has reason to believe that articles of cheese are being subsidized and offered for sale at prices below the domestic wholesale price may file a complaint. Quota cheese which is subsidized and sold in the United States below the domestic wholesale price is deemed to materially injure the domestic market for comparable products. Upon receipt of such a complaint, the Secretary of Agriculture has thirty (30) days to investigate and determine whether subsidized cheese imports are undercutting similar domestic cheese prices. The Secretary of Agriculture reaches a price-undercutting determination by identifying the domestic wholsale market area, the duty-paid wholesale price of the import and the domestic wholesale price of the similar article produced in the United States. If the Secretary determines tha price-undercutting exists and the offender takes no action to stop the price-undercutting, the President of the United States can impose a fee to offset the price-undercutting or he can prohibit the entry, in whole or in part, of the article of quota cheese.

The Association advocates the elimination of the entire price-undercutting law for ten (10) reasons.

First: The price-undercutting law subjects cheese imports to "double jeopardy". Import quotas were established at quantity levels which were deemed not to injure the sales of domestic products. The price-undercutting law directly undermines this notion by adding price as a factor in the determination of injury to the sales of domestic cheese. Thus, importers are regulated by the imposition of both quotas and price controls on the same imported cheese. Price should not be a factor. It is ironic that the United States insists on worsening its trade balance by forcing suppliers to charge and U.S. importers to pay higher prices.

Second: The price-undercutting scheme should be eliminated because the regulations tend to restrict the use of licenses. The artificially high prices mandated by the price-undercutting scheme often force importers who cannot market the product to refrain from using their licenses.

Third: The Administration advocates a diminution in regulation of the private sector by the government. During the 1980 campaign, both presidential candidates argued against government spending and government waste. The elimination of the price-undercutting law would fulfill the President's campaign promise to decrease the role of burdensome government regulation.

Fourth: The price-undercutting law unduly penalizes importers because it can result in a double duty on cheese. The fee operates as a double tariff because an importer pays an initial duty when he imports cheese into this country. Then, if he is found to be price-undercutting, he and all other importers of the same item may be penalized by the imposition of a fee. Those who are at higher price levels are penalized for the actions of one importer who sells the same article of cheese below the domestic wholesale price. The elimination of the price-undercutting law would eliminate its excessive and inequitable penalties.

Fifth: The regulations prohibiting price-undercutting are ambiguous. For instance, section 6.40 of the regulations describes the procedures to determine whether any article of quota cheese is being offered for sale in the United States at a price lower than the domestic wholesale market price of similar articles. The regulation is ambiguous because it does not state whether the quota cheese must be offered for sale by an exporter, an importer or a wholesaler.

Sixth: The price-undercutting scheme is unfair because it penalizes importers who pay for cheese in foreign currencies. An importer who buys in a foreign currency cannot know when he purchases cheese whether, as a result of constant revaluations of the currency, his cheese will undercut the domestic wholesale price of cheese when he pays his bill. Therefore, the importer may inadvertently and for reasons beyond his control be accused of price-undercutting.

Seventh: The price-undercutting regulations are unfair because they focus on the price of cheese without taking into consideration any material injury to the complainant. Thus, a domestic manufacturer of small amounts of a cheese variety who is hardly materially injured as a result of the importation of price-undercutting cheese can file a complaint that may result in the imposition of a fee against all importers of the same article of cheese. This inattention to the complainant's material injury in the regulation is unfair to the bulk of importers.

Eighth: The elimination of the price-undercutting law will not undermine the existing counterveiling duty law (19 U.S.C. § 1671, et. seq.). The "fast track" process of section 702 was adopted to supersede the counterveiling duty law. The elimination of this "fast track" process, however, will still leave intact the law requiring the imposition of a counterveiling duty upon subsidized merchandise that materially injures an industry in the United States. Domestic cheese manufacturers are therefore protected from material injury to the industry.

Ninth: The price-undercutting law is inequitable because it requires the Secretary of Agriculture to reach a price-undercutting determination thirty (30) days after the receipt of a complaint. The thirty (30) day process provides too little time for the Secretary to carefully study and verify the relevant factors necessary for a price-undercutting determination. Any longer period of time would not be in keeping with the fast track concept.

Tenth: The price-undercutting law is unworkable because it requires the Department of Agriculture, the foreign entity and the importer to know the wholesale price of cheese in the United States without supplying any provisions for such knowledge. It is ironic that the Department of Agriculture, in only (30) days, must verify the domestic wholesale price for cheese without the aid of a published list of market prices.

In sum, the price-undercutting scheme amounts to a nontariff barrier which prevents full utilization of licenses in direct contravention of GATT.

II. A TRIGGER MECHANISM SHOULD BE IMPLEMENTED FOR THE TRANSFER OF LICENSES

The procedure governing the transfer of licenses under the present system is costly, burdensome and unworkable. The regulations subject the United States government to the control of foreign governments. Countries of origin often wait until the end of the quota year before declaring whether cheese is unavailable. Licensees who are then granted a transfer of license risk incurring a penalty for their failure to utilize 85 percent of their license in the short time before the end of the quota year. This nontariff barrier leads to the underutilization of licenses. We have attached for this Subcommittee's convenience, charts labeled Exhibits A and B which show the percentage of quota utilization for particular cheese varieties during 1980 and 1979.

Section 6.30 of the regulations allows a licensee to request a transfer of the unfilled portion of his license from the quota country of origin upon the submission of proof to the Licensing Authority that he will be unable to enter his quota share. The country of origin may support or deny the licensee's claim that cheese is unavailable. After considering "satisfactory proof" submitted by the licensee and "taking due account of any special factors which may have affected or may be affecting trade," the Department of Agriculture can then authorize the licensee to obtain the unfilled portion of his quota shares from another country of origin.

Instead of continuing this burdensome, unworkable procedure, the Association proposes that a trigger mechanism be implemented for the transfer of licenses. We suggest that if at least 20 percent of the total quota for a particular article has not been entered by July 1st of any year, then licenses for 50 percent of the total quota shall be transferred. By September 1st of any year, if at least 45 percent of the total quota has not been entered, then the balance of the quota shall be transferred. This trigger mechanism will supplement and exist in conjunction with the present procedures for the transfer of licenses.

The Association advocates this trigger mechanism for seven (7) reasons.

First: Regulations governing import licenses are designed to facilitate the maximum utilization of quotas for each article. Our proposal to implement a trigger mechanism for the transfer of licenses will, in the spirit of the regulations, maximize the utilization of cheese licenses.

Second: The current regulations are interpreted to depend solely on the availability of cheese in their eligibility requirement for transfer. This focus ignores the common sense reality that prohibits an importer from buying cheese which cannot be marketed at a profit. The trigger mechanism, by contrast, will allow an importer to assess other important factors before using his license.

Third: The trigger mechanism will end the unfairness of a foreign country controlling the business of United States cheese importers. Under current provisions, an importer has the burden of proving that cheese is unavailable before he can be granted a transfer of license. The proof submitted by the importer is often challenged by a foreign government which is not required to submit its own proof. Thus, a foreign government plays the principal role in determining whether a United States importer can transfer his license. The trigger mechanism will stop the direct control accorded foreign governments in the determination of transfer eligibility.

Fourth: The automatic trigger mechanism will bring an end to the costly and cumbersome paperwork processed by the United States Department of Agriculture. By providing a computerized automatic indicator for transfer eligibility, the trigger mechanism will alleviate a substantial portion of reallocation work performed at the end of the year. This mechanism will provide an orderly marketing structure.

Fifth: The trigger mechanism will eliminate an unfairness inherent in the present system. An importer must often wait until near the end of a quota year before obtaining proof that cheese is unavailable. Then, after the transfer is granted, the importer may be penalized the following year if he is unable to fill at least 85% of his license because of short lead time. The automatic trigger mechanism will eliminate this unfairness and avoid the likelihood of a penalty at the end of the year.

Sixth: The trigger mechanism will eliminate the problem of compliance with an ambiguous regulation. Section 6.30 of the regulations is ambiguous because it does not explain the kind of proof that constitutes "proof satisfactory". The section also does not explain the "special factors" that the United States Department of Agriculture may consider in reaching its transfer determination.

Seventh: The quotas negotiated with foreign countries will remain undisturbed. Countries of origin will remain a licensee's supplier of quota articles for the current year and for future years.

The trigger mechanism will eliminate the nontariff barriers to the transfer of licenses which directly contravene GATT. In so doing, the mechanism will "facilitate the maximum utilization of the respective quotas for . . . articles" as provided by section 6.20 of the regulations.

We have attached, for this Subcommittee's convenience, charts labeled Exhibits C and D which show the percentage of annual cheese imports through the months of June and August during 1981 and 1980. We have provided this information to show that 20% and 45% of the total quota are realistic percentages for July 1st and September 1st of any year.

III. THE PREFERRED IMPORTER STATUS SHOULD BE ELIMINATED

The preferred importer status results in the deprivation of licenses to American importers and the "give away" of one-third of all American licenses to foreign countries. The provision allows foreign governments to choose trading partners and to establish their own companies as exclusive customers. The excessive control accorded foreign exporters under this provision is contrary to the spirit of our laissez-faire system and does not operate in the best interests of the United States. Our members therefore recommend the elimination of this provision.

A preferred importer becomes the receiver of a supplementary license upon being endorsed and granted a favored status by a supplying country.

Prior to the Trade Agreements Act, all licenses were distributed to American importers. Foreign cheese exporters sold directly to U.S. importers. Provisions for the designation of preferred importers were introduced in the regulations to accommodate the wishes of certain countries to gain control over business newly placed under quota. In its enactment of the preferred importer status, however, the Department of Agriculture exceeded its written instructions from Congress. The Department of Agriculture deprived American importers of their just licenses by allocating import licenses to designees of the exporters. Therefore, the great bulk of preferred licenses are now de facto in the hands of foreign exporters who have established their own U.S. companies as exclusive customers.

Our members advocate the elimination of the preferred importers status for four (4) reasons.

First: Licenses given to preferred importers are licenses carved out of the pool of American import licenses. New entrants were therefore deprived of opportunities to enter the industry.

Second: The preferred importer status bestows too much power upon foreign countries to control the sale of cheese in the United States. Foreign countries have, in the past, established their own exclusive selling agents in the United States. These exclusive selling agents and the governments they represent have always controlled the price, quantity, variety and shipment of cheese. The preferred importer provision, however, allows the selling agent to become the importer. In fact, in a number of cases, the foreign government and/or the exporter and the preferred importer are one and the same. A foreign country is thereby given too much control over the utilization of quotas and the allocation of licenses. American importers are prevented from participating in the cheese import industry.

Third: The United States government is losing taxable income earned in this country as a result of the preferred importer status because the agencies, as arms of the foreign governments, are not motivated to generate their taxable earnings in this country. The loss of this taxable income is contrary to the historical realization of tax revenues for this country by the distribution of licenses to American importers.

Fourth: The right of foreign countries to designate preferred importers interferes with the allocation of import licenses by the Department of Agriculture. The Department is therefore hampered in its licensing authority.

In summary, the designation of preferred importers to accommodate foreign interest unjustly subjects the cheese import industry to excessive controls, adversely affects the United States treasury, sequesters established import businesses and curtails the expansion of the industry.

The Association therefore recommends that licenses allocated to preferred importers be reallocated to new licensees, price-break cheese importers and historical licensees.

IV. TWO THOUSAND TONS OF AUTHORIZED CHEESE IMPORT QUOTAS SHOULD BE ALLOCATED

Price-break licensees, new entrants and licensees harmed by unintended inequities under certain license provisions need the increased availability of licenses to ease disparities under certain license provisions and to encourage growth in the cheese import industry. These licensees therefore support the judicious allocation of the 2,000 tons of authorized quota cheese licenses that were never issued.

Section 701 of the Trade Agreements Act of 1979 authorized the President of the United States to designate a maximum allowable cheese import quota of 111,000 metric tons for any calendar year. The President has designated 109,000 metric tons in Proclamation 4706 on December 11, 1979. Members of the Special Trade Representative's office in Washington, D.C. have stated that the unallocated 2,000 tons have been reserved for the European community. Thomas R. Hughes, Administrator of the Foreign Agricultural Service, explained the reason for not allocating the 2,000 metric tons of authorized cheese import quotas in a letter to Charles A. Vanik, Chairman of the House Ways and Means Committee, dated October 23, 1980 when he wrote:

[The 2,000 MT] was promised as a concession to the European Community (EC), provided they make certain concessions in certain other commodity areas. To date the EC has not come forth with the concessions necessary. When they do, it is our understanding that the remaining 2,000 MT will be allocated by amending Proclamation 4706. *It is also our understanding that should it become clear that the EC is unable to make the necessary concessions, the 2,000 MT will be used in negotiations with one or more of several other countries which have expressed an interest in it.* (emphasis added).

These 2,000 metric tons of reserved quota shares should be allocated because they are no longer useful as a bargaining tool for concessions at an international economic conference. The Multilateral Trade Negotiations were concluded more than two years ago and the results of that conference have been enacted into law. Items negotiated at the conference should now be implemented.

Moreover, by allowing the unallocated 2,000 metric tons to remain idle, it is not the exporters who suffer but the cheese importers who are punished by the denial of an opportunity to fill these quota shares. Setting aside these 2,000 tons directly contradicts the aim of the United States government to maximize the use of quotas.

The allocation of the 2,000 tons of reserved quota would especially benefit those importers who were unintentionally injured by certain license provisions. For example, the USDA could use the unallocated quota shares to increase the license of an importer who, because of formula provisions, received licenses for less than 100% of his actual "price-break cheese" imports. Or, if a particular license provision operated to deprive a cheese importer of a substantial amount of his previous actual business, the Department of Agriculture could improve the licensee's situation by distributing some of the unallocated quota shares to him.

The distribution of the unallocated 2,000 tons would help the cheese import industry and ease disparities for hardship cases.

V. NATURAL AND PROCESSED CHEESE LICENSES SHOULD BE COMBINED

Cheese importers are prevented from the full utilization of their licenses by separate quotas for some natural and processed cheeses of the same variety. Currently, the regulations separate the natural and processed licenses of Edam and Gouda, Gruyere and Swiss cheeses. By comparison, the regulations combine the natural and processed licenses of Blue-mold, Cheddar and American-type cheeses. The regulations are therefore inconsistent.

The Association advocates combining natural and processed licenses for all cheese varieties to determine total quota shares. Such a combination would encourage full utilization of licenses by importers. Moreover, combining natural and processed licenses for all cheese varieties would reduce the administrative burden for the Department of Agriculture.

VI. QUOTAS SHOULD BE INCREASED

The import cheese industry is curtailed in its growth by fixed quota shares. This formidable entry barrier prevents cheese importers from servicing the growing demand for cheese from a dynamic society whose per capita consumption and population continues to increase.

The Association therefore proposes that beginning January 1, 1983 quotas automatically increase every year in accordance with a growth factor formula. The formula might be based on one of the following alternative growth factors.

We suggest that the increase in quotas be tied to per capita cheese consumption. Therefore, as cheese consumption increases, so too would the quota shares. Per capita cheese consumption is easily ascertainable because the United States Department of Agriculture publishes this figure every year.

An alternative growth factor could tie the increase in quotas to the increase in the population of the United States. As the population increases, so too would the quota shares.

An equation which provides for the automatic increase in quota shares based on the increase in per capita consumption or the population would properly relate imports to the requirements of the American consumer. Rather than arbitrarily fixing the number of quota shares during irregular intervals at international economic conferences, the use of a growth factor on which to compute an automatic increase in quotas would provide a dynamic mechanism for smoothly filling the needs of our consumers in orderly fashion as related to the American economy.

CONCLUSION

The Association advocates changes in the quota licensing system as a means to reaffirm the commitment articulated by the House Ways and Means Committee to "allocate new license rights so as to protect both the rights of those who have traditionally been in the business of importing cheese quotas and the rights of price-break cheese importers who have had no historical record of holding licenses, as well as new entrants to the cheese importing business" and "to take all necessary measures to permit the maximum utilization of quotas".

Exhibit A

1 9 8 0[1]

TSUS Item No.	Product	Calendar Year Quota (Thousand Pounds)	1980 Imports (Thousand pounds)	Percentage Imported of Total Quota (Thousand pounds)
	American			
950.08A	- Cheddar	12,205.3	10,710	87.7
950.08B	- Other	7,545.4	7,367	97.6
	Italian			
950.10	- Original Loaves	12,374.4	5,998	48.5
950.10A	- Other	1,550.0	1,059	68.3
	Edam and Gouda			
950.09A	- Natural	9,208.6	8,572	93.1
950.09B	- Processed	3,151.3	2,019	64.1
950.07	Blue Mold	5,469.6	4,388	80.2
	Swiss			
950.10B	- Emmenthaler	70,228.1	66,608	94.8
950.10C	- Gruyere Process	15,597.2	14,060	90.1
	Other			
950.10D	- Over 0.5% fat	90,192.1	67,370	74.7
950.10E	- Under 0.5% fat	12,621.1	7,194	56.9
	Total	240,143.1	195,345	81.3

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[1] Preliminary as of 11/30/81.

SOURCE: U.S. Department of Commerce, Bureau of the Census.

Exhibit B

1 9 7 9[1]

TSUS Item No.	Product	Calendar Year Quota (Thousand Pounds)	1979 Imports (Thousand pounds)	Percentage Imported of Total Quota (Thousand pounds)
	American			
950.08A	- Cheddar	10,037.5	10,257[3]	100
950.08B	- Other	6,096.6	7,707[3]	100
	Italian			
950.10	- Original Loaves	11,500.1	6,695	58.2
950.10A	- Other	1,494.0	997	68.7
	Edam and Gouda			
950.09A	- Natural	9,200.4	8,559	93.0
950.09B	- Processed	3,151.0	1,283	40.7
950.07	Blue Mold	5,017.0	4,335	86.4
	Swiss[2]			
950.10B	- Emmenthaler	20,420.0	19,638	96.2
950.10C	- Gruyere Process	11,242.0	11,026	98.1
	Other[2]			
950.10D	- Over 0.5% fat	40,730.0	42,892	100
950.10E	- Under 0.5% fat	8,901.0	4,869	54.7
	Total	127,789.6	118,259	92.5

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[1] Preliminary as of 11/30/81.

[2] Subject to quota if f.o.b. price is less than "pricebreak" (7 cents above the American cheese support price, rounded to nearest whole cent — $1.31 effective October 12, 1979).

[3] Probable error in reported data noted by U.S. Department of Commerce, Bureau of the Census because amount imported exceeded calendar year quota.

SOURCE: U.S. Department of Commerce, Bureau of the Census.

Exhibit C

1 9 8 1[1]

TSUS Item No.	Product	Calendar Year Quota (Thousand pounds)	January-June		Jaunary-August	
			Imports	Percentage of Total Imports (Thousand pounds)	Imports	Percentage of Total Imports (Thousand pounds)
	American					
950.08A	- Cheddar	12,205.3	5,318	43.6	6,685	54.8
950.08B	- Other	7,545.4	1,238	16.4	1,823	24.2
	Italian					
950.10	- Original Loaves	12,374.4	2,947	23.8	3,833	31.0
950.10A	- Other	1,550.0	295	19.0	355	22.9
	Edam and Gouda					
950.09A	- Natural	9,208.6	4,485	48.7	6,255	67.9
950.09B	- Processed	3,151.3	884	28.1	1,379	43.8
950.07	Blue Mold	5,469.6	1,884	34.4	2,687	49.1
	Swiss					
950.10B	- Emmenthaler	70,278.1	27,099	38.6	39,091	55.6
950.10C	- Gruyere Process	16,479.0	4,850	29.4	7,085	43.0
	Other					
950.10D	- Over 0.5% fat	89,466.8	18,761	21.0	26,787	29.9
950.10E	- Under 0.5% fat	12,621.1	3,473	27.5	5,831	46.2
	Total	240,349.6	71,233	29.6	101,810	42.4

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[1] Preliminary as of 11/30/81.

SOURCE: U.S. Department of Commerce, Bureau of the Census.

Exhibit D

1 9 8 0[1]

TSUS Item No.	Product	Calendar Year Quota (Thousand pounds)	January-June Imports	January-June Percentage of Total Imports (Thousand pounds)	January-August Imports	January-August Percentage of Total Imports (Thousand pounds)
	American					
950.08A	- Cheddar	12,205.3	1,668	13.7	4,700	38.5
950.08B	- Other	7,545.4	442	5.9	1,083	14.4
	Italian					
950.10	- Original Loaves	12,374.4	3,018	24.4	3,686	29.8
950.10A	- Other	1,550.0	475	30.6	605	39.0
	Edam and Gouda					
950.09A	- Natural	9,208.6	2,979	32.4	4,439	48.2
950.09B	- Processed	3,151.3	346	11.0	662	21.0
950.07	Blue Mold	5,469.6	1,233	22.5	2,199	40.2
	Swiss					
950.10B	- Emmenthaler	70,228.1	21,180	30.2	31,536	44.9
950.10C	- Gruyere Process	15,597.2	5,135	32.9	7,995	51.3
	Other					
950.10D	- Over 0.5% fat	90,192.1	13,615	15.1	21,538	23.9
950.10E	- Under 0.5% fat	12,621.1	825	6.5	1,807	14.3
	Total	240,143.1	50,916	21.2	80,250	33.4

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[1] Preliminary as of 11/30/81.

SOURCE: U.S. Department of Commerce, Bureau of the Census.

Sections 701 and 702 of the Trade Agreements Act of 1979

SEC. 701. LIMITATION ON CHEESE IMPORTS.

19 USC 1202 note.

(a) PROCLAMATION.—The President shall by proclamation limit the amount of quota cheese which may enter the customs territory of the United States in any calendar year after 1979 to not more than 111,000 metric tons. Any such proclamation shall be considered a proclamation which is issued by the President under section 22 of the Agricultural Adjustment Act (7 U.S.C. 624) and which meets the requirements of such section.

(b) RESTRICTION ON EMERGENCY ACTION.—No increase in the amount proclaimed under subsection (a) to an amount greater than 111,000 metric tons for any calendar year may be proclaimed except in accordance with section 22 of the Agricultural Adjustment Act. The President may not proclaim any such increase to an amount greater than 111,000 metric tons by use of the procedure established for immediate action by the second paragraph of subsection (b) of such section, at any time before January 1, 1983, unless the Secretary determines that extraordinary circumstances warrant such action and reports such determination to the President.

(c) DEFINITIONS.—For purposes of this title—

(1) QUOTA CHEESE.—The term "quota cheese" means the articles provided for in the following items of the Tariff Schedules of the United States: 19 USC 1202.

(A) 117.00 (except Stilton produced in the United Kingdom);

(B) 117.05 (except Stilton produced in the United Kingdom);

(C) 117.15;

(D) 117.20;

(E) 117.25;

(F) 117.40 (except Goya in original loaves);

(G) 117.55;

(H) 117.60 (except Gammelost and Nokkelost);

(I) 117.75 (except goat's milk cheeses and soft-ripened cow's milk cheeses);

(J) 117.81; and

(K) 117.85 (except goat's milk cheeses and soft-ripened cow's milk cheeses).

(2) SECRETARY.—The term "Secretary" means the Secretary of Agriculture.

SEC. 702. ENFORCEMENT.

(a) DETERMINATION AND LISTING OF SUBSIDIES.— 19 USC 1202 note.

(1) INITIAL DETERMINATION AND ANNUAL LISTING.—Not later than January 1, 1980, the administering authority shall—

(A) determine, in consultation with the Secretary, whether any foreign government is providing a subsidy with respect to any article of quota cheese, and

(B) publish a list of the type and the amount of each such subsidy which is determined to exist.

Not later than January 1 of each year beginning with 1981, the administering authority shall republish such list, incorporating the changes and additional subsidies determined for the preceding calendar year under paragraph (2).

(2) QUARTERLY DETERMINATION OF CHANGES AND ADDITIONAL SUBSIDIES.—Not later than April 1, July 1, and October 1 of each year beginning with 1980, and not later than January 1 of each year beginning with 1981, the administering authority shall determine, in consultation with the Secretary—

(A) whether any changes in the type or amount of any subsidy included in the current annual list under paragraph (1) (as modified by quarterly lists under this paragraph) have occurred, and

(B) whether any subsidy not included in such list is being provided with respect to any article of quota cheese by a foreign government, and the type and amount of any such subsidy which is determined to exist.

Not later than April 1, July 1, and October 1, the administering authority shall publish such changes and additional subsidies for the preceding calendar quarter.

(3) ADDITIONAL DETERMINATIONS.—Any person, including the Secretary, may request the administering authority to make a determination under subparagraph (A) or (B) of paragraph (2). Not later than 30 days after receiving such a request, the

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administering authority shall (A) make the determination, in consultation with the Secretary, (B) notify the person making the request of such determination, and (C) publish such modification, if any. Any such determination shall be in addition to the quarterly determinations required under paragraph (2). Requests made under this paragraph shall be supported by information reasonably available to the person requesting the determination.

(b) COMPLAINTS OF PRICE-UNDERCUTTING BY SUBSIDIZED IMPORTS.—

(1) IN GENERAL.—Any person may make a written complaint to the Secretary alleging that—

"Duty-paid wholesale price."

(A) the price at which any article of quota cheese is offered for sale in the United States on a duty-paid wholesale basis (hereinafter in this section referred to as the "duty-paid wholesale price") is less than the domestic wholesale market price of similar articles produced in the United States, and

(B) a foreign government is providing a subsidy with respect to such article of quota cheese.

(2) DETERMINATIONS.—(A) The Secretary shall investigate and determine, not later than 30 days after receiving a complaint under paragraph (1), the validity of the allegations made under paragraph (1)(A).

(B) Except as otherwise provided in this subparagraph, the existence and the type and amount of any subsidy alleged under paragraph (1)(B) shall be determined by reference to the current list, as determined and published under subsection (a). If the complaint alleges a subsidy which is not included in such current list, or which is different in type or amount from a subsidy which is included in such current list, the Secretary shall immediately request the administering authority to make a determination with respect to the subsidy pursuant to subsection (a)(3). The administering authority shall make such determination in accordance with such subsection and shall report such determination to the Secretary.

(c) REPORTS OF DETERMINATIONS.—

Publication in Federal Register.

(1) PUBLICATION.—The Secretary shall publish the determinations made under subsection (b) in the Federal Register not later than 5 days after the date on which the Secretary makes his determination under subsection (b)(2)(A).

(2) NOTIFICATION OF FOREIGN GOVERNMENT.—Whenever it is determined under subsection (b) that the duty-paid wholesale price of any article of quota cheese is less than the domestic wholesale market price of a similar article produced in the United States and that a foreign government is providing a subsidy with respect to such article of quota cheese, the Secretary shall immediately notify the Special Representative for Trade Negotiations. The Special Representative shall notify the foreign government or governments involved of such determination not later than 3 days after the date on which the Secretary makes his determination under subsection (b)(2)(A).

(3) REPORT TO PRESIDENT.—If, within 15 days after receiving notification under paragraph (2), the foreign government does not eliminate the subsidy or take such action as may be necessary to ensure that the duty-paid wholesale price of the article of quota cheese will not be less than the domestic wholesale market price of similar articles produced in the United States, the Secretary shall immediately—

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(A) report the determinations under subsection (b) to the President, and

(B) recommend the imposition of a fee or quantitative limitation with respect to the importation of such article of quota cheese from the country involved, in such amount as the Secretary determines necessary.

(d) PRESIDENTIAL ACTION.—

(1) IN GENERAL.—Not later than 7 days after receiving a report under subsection (c)(3) with respect to an article of quota cheese (or not later than 3 days after receiving a report under paragraph (2) of this subsection in any case in which such paragraph applies), the President shall—

Importation fee.

(A) proclaim the imposition of a fee on the importation of such article from the country involved in such amount (not to exceed the amount of the subsidy determined under subsection (b)(2)(B)) as may be necessary to ensure that the duty-paid wholesale price of such article will not be less than the domestic wholesale market price of similar articles produced in the United States, or

(B) proclaim a prohibition on the entry, in whole or part, of such article of quota cheese from such country into the United States,

and shall direct the Commissioner of Customs to administer and enforce such fee or quantitative limitation. Any fee imposed under subparagraph (A) or any quantitative limitation imposed under subparagraph (B) shall be in addition to any other fee or quantitative limitation imposed by law on the importation of quota cheese.

Report to President.

Proclamation.

(2) ADDITIONAL INVESTIGATION.—If the President finds that the determinations or recommendations of the Secretary reported under subsection (c)(3) are unsubstantiated by fact, he shall, not later than 7 days after receiving such report, notify the Secretary and direct him to make a further investigation. The Secretary shall, within 7 days of receiving such notification, make such investigation and report his findings to the President, including any modification in such determinations or recommendations. The President shall thereupon make the proclamation required by paragraph (1), unless the Secretary finds that there is no basis for the determinations or recommendations reported under subsection (c)(3) whether or not modified.

19 USC 1654.

(e) ADMINISTRATION.—Any fee or quantitative limitation proclaimed pursuant to subsection (d) and any termination or modification thereof pursuant to subsection (g) shall apply with respect to articles entered, or withdrawn from warehouse, for consumption after the date which is 3 days after the President makes the proclamation required by subsection (d). Such fees shall be treated for administrative purposes as duties imposed by the Tariff Act of 1930, but shall not be considered as duties for the purpose of granting any preferential concession under any law or international obligation of the United States.

Ante, p. 150.
19 USC 1303.

(f) INAPPLICABILITY OF COUNTERVAILING DUTIES DURING EFFECTIVE PERIOD OF CHEESE AGREEMENTS.—No countervailing duty shall be imposed under title I of this Act or under section 303 of the Tariff Act of 1930 with respect to an article of quota cheese which is the product of any country at any time during which an agreement relating to cheese described in section 2(c)(8) containing a commitment from a foreign government with respect to price undercutting is in effect between the United States and such country.

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(g) TERMINATION OR MODIFICATION OF PRESIDENTIAL ACTION.—

(1) TERMINATION.—If, at any time after the President takes an action under subsection (d) with respect to the importation from a foreign country of an article of quota cheese, the Secretary receives reasonable evidence and assurance that, with respect to future entries of such article into the customs territory of the United States—

(A) the duty-paid wholesale price of such article will not be less than the domestic wholesale market price of similar articles produced in the United States, or

(B) the foreign government will no longer provide a subsidy with respect to such article of quota cheese,

Report to President. Proclamation.

the Secretary shall notify the President of such finding and the President shall, by proclamation, terminate such action with respect to the importation of such article from such country.

(2) MODIFICATION.—The Secretary shall recommend to the President such modifications of fees or quantitative limitations imposed under subsection (d) with respect to any article of quota cheese as may be necessary to ensure that the duty-paid wholesale price of such article will not be less than the domestic wholesale market price of similar articles produced in the United States, and the President shall, by proclamation, make such modifications. The amount of any fee, as so modified, shall not be greater than the amount of the subsidy provided by the foreign government with respect to the article of quota cheese.

Proclamation.

(h) DEFINITIONS.—For purposes of this section—

(1) ADMINISTERING AUTHORITY.—The term "administering authority" has the same meaning such term has in section 771(1) of the Tariff Act of 1930.

Ante, p. 176.

(2) SUBSIDY.—The term "subsidy" has the same meaning such term has in section 771(5) of the Tariff Act of 1930.

(3) DOMESTIC WHOLESALE MARKET, DOMESTIC WHOLESALE MARKET PRICE, AND DUTY-PAID WHOLESALE PRICE.—The domestic wholesale market and the domestic wholesale market price of any article similar to an article of quota cheese, and the duty-paid wholesale price of any article of quota cheese shall be determined under regulations prescribed by the Secretary not later than January 1, 1980, in accordance with chapter 5 of title 5 of the United States Code.

5 USC 500 *et. seq.*

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Subpart—Price-Undercutting of Domestic Cheese by Quota Cheeses

AUTHORITY: Sec. 702, P.L. 96-39, 93 Stat. 144, 19 U.S.C. 1202 note.

SOURCE: 45 FR 9883, Feb. 13, 1980, unless otherwise noted.

§ 6.40 General.

This subpart sets forth the procedures applicable to the determination by the Secretary of Agriculture as to whether the price at which any article of quota cheese is being offered for sale in the United States on a duty-paid wholesale basis is less than the domestic wholesale market price of similar articles produced in the United States (i.e., price-undercutting) in accordance with Section 702 of the Trade Agreements Act of 1979 (Pub. L. 96-39, 93 Stat. 144, 19 U.S.C. 1202 note) (hereinafter referred to as the Act).

§ 6.41 Definitions.

(a) "Complainant" means the person who has filed with the Investigating Authority, in accordance with the procedures set forth in this Subpart, a written complaint alleging that price-undercutting is occurring.

(b) "Country of origin" means the country, as defined in 19 CFR 134.1(b), in which the quota article subject to this regulation was produced or manufactured.

(c) "Foreign government" means the government of the country of origin or, for purposes of determining whether a subsidy has been provided for the member states of the European Economic Community, the subsidy granting bodies of the European Economic Community.

(d) "Investigating Authority" means the Director, Dairy, Livestock and Poultry Division, Commodity Programs, Foreign Agricultural Service.

(e) "Quota cheese" means the articles provided for in the following items of the Tariff Schedules of the United States:

117.00 (except Stilton produced in the United Kingdom);
117.05 (except Stilton produced in the United Kingdom);
117.15;
117.20;
117.25;
117.42;
117.44;
117.55;
117.60 (except Gammelost and Nokkelost);
117.75 (except goat's milk cheeses and soft-ripened cow's milk cheeses);
117.81;
117.86;
117.88 (except goat's milk cheeses and soft-ripened cow's milk cheeses);

(f) "Secretary" means the Secretary of Agriculture.

(g) "Subsidy" has the same meaning as such term has in Section 771(5) of the Tariff Act of 1930 as added by Section 101 of the Trade Agreements Act of 1979 (19 USC 1677(5)).

(h) The "United States" means the Customs Territory of the United States, which is limited to the United States, District of Columbia and Puerto Rico.

§ 6.42 Complaints of price-undercutting.

(a) *Submission of complaint.* Any person who has reason to believe that the price at which any article of quota cheese is offered for sale or sold in the United States on a duty-paid wholesale price basis is less than the domestic wholesale market price of similar articiles produced in the United States and that a foreign government is providing a subsidy with respect to such article of quota cheese may file with the Investigating Authority a written complaint making such allegation.

(b) *Contents of complaint.* Such complaint shall contain, or be accompanied by, information to substantiate complainant's allegations, in substantially the following form:

(1) The name and address of the complainant.

(2) The location of the domestic wholesale market in which price-undercutting is alleged to be occurring.

(3) The article of quota cheese involved in the alleged price-undercutting.

(4) The country of origin of such article of quota cheese.

(5) The similar domestic article, the price of which the complainant believes is being undercut.

(6) The month and year that the complainant first concluded that the price-undercutting was taking place.

(7) To extent known to the complainant, all pertinent facts with regard to the alleged subsidy, and, if known, the statutory or other authority under which it is paid, the manner in which it is paid, and the value of such subsidy when received and used by producers or sellers of such quota cheese.

(8) All other information which the complainant believes substantiates the allegation of price-undercutting, including the complainant's estimate of the domestic wholesale market price of the similar article produced in the United States and the duty-paid wholesale price of the quota cheese involved. If available, samples of the domestic and imported cheese products should be submitted.

§ 6.43 Determinations.

(a) *Making determinations.* Not later than 30 days after receiving an acceptable complaint, as described in § 6.42(b), alleging price-undercutting, the Secretary shall make a determination as to the validity of the allegation. In making such determination, the following shall apply:

(1) The "domestic wholesale market" shall be one or more of the three major U.S. market areas, viz., New York City, Chicago, and San Francisco, and/or any other market area within the Customs Territory of the United States, which the Investigating Authority determines most representative of the area specified by the complainant as the one in which price-undercutting is alleged to be occurring (hereinafter referred to as "designated area").

(2) The "duty-paid wholesale price" determined by the Investigating Authority shall be the average of prices at which wholesalers have sold or offered for sale in the designated area the article of quota cheese alleged to be involved in price-undercutting, as obtained in a survey directed by the Investigating Authority during the investigation: Provided, That whenever the designated area is not or does not include one of the major market areas specified in paragraph (a)(1) of this section, the Investigating Authority may adjust the average of prices determined for such designated area on the basis of the average of prices determined for the major market area which is determined to be the most representative of the designated area, taking into consideration any special factors which may be affecting prices in the designated area.

(3) The "domestic wholesale market price" determined by the Investigating Authority for a similar article produced in the United States to that article of quota cheese which is alleged to be involved in price-undercutting shall be the average of prices at which wholesalers have sold the similar article produced in the United States in the designated area, as obtained in a survey directed by the Investigating Authority during the investigation: Provided, That whenever the designated area is not or does not include one of the major market areas specified in paragraph (a)(1) of this section, the Investigating Authority may adjust the average of prices determined for such designated area on the basis of the average of prices determined for the major market area which is determined to be the most representative of the designated aren, taking into consideration any special factors which may be affecting prices in the designated area.

(4) "Similar article produced in the United States" shall be an article of cheese, cheese product, or imitation cheese produced in the United States and marketed in the domestic wholesale market, which is determined by the Investigating Authority, based upon available information to be most like the imported article of quota cheese alleged to be involved in price-undercutting, in terms of its physical properties and end use. In making this determination, first consideration shall be given to the normal end uses of the article produced in the United States in comparison with the end use of the article of quota cheese alleged to be involved in price-undercutting. If the end use of both articles is determined to be the same (e.g., processing or retail sale), the physical characteristics of the two articles shall be considered.

If the common end use of the two articles is processing, the representative samples of the two articles shall be examined in terms of processing quality, taking special note of processing yields. If the common end use of the two articles is retail sale, representative samples of the two articles shall be examined in terms of similarities of taste, texture, general appearance, quality, age, and packaging. Imported imitation quota cheese shall only be compared with imitation domestic cheese. If it is determined that the domestic cheese the price of which is claimed to be undercut is not similar to the quota cheese allegedly undercutting it, there shall be no finding of price-undercutting.

(b) *Reporting determinations.* Determinations by the Secretary as to the validity of allegations of price-undercutting made under this Subpart shall be published in the FEDERAL REGISTER not later than 5 days after the date the determination is made.

§ 6.44 Delegation of authority.

The powers vested in the Administrator, FAS, insofar as such powers relate to the functions of the Investigating Authority by this regulation are hereby delegated to the Investigating Authority.This final rule has been reviewed under the USDA criteria estblsihed to implement Executive Order 12044, "Improving Government Regulations," a determination has been made that this action should not be classified "significant" under those criteria. A Final Impact Statement has been prepared and is available from Carol M. Harvey in Room 6622, South Agriculture Building, 14th and Independence Ave., SW., Washington, D.C. 20250.

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Chairman GIBBONS. Thank you for your statement. Let me say I realize there is something seriously wrong with our cheese situation when I look at the prices in the supermarkets, and I do. I also know in this last agricultural bill we probably are going to pile up more cheese, American cheese.

I don't know whether the Government is going to be able to reduce its stocks by giving away cheese to disadvantaged people, but I know we have problems. I appreciate your suggestions as to how we ought to solve these problems.

They are reasonable. They are very conservative suggestions about the way to open up the market. I realize it is a complicated market and perhaps we can make some recommendations as to what should be done about it. There are a few things that you learn as you go through the legislative process that you always hate to take up.

Cheese is one of them; fishing is another. I could name a whole lot of other things but agricultural products are uniquely controversial, not only in this country, but throughout the world. I think you have made reasonable suggestions as to what can be done about cleaning it up.

Are there any other questions for this panel of witnesses? Do any of the rest of you wish to make a statement?

Mr. STEINKE. Our counsel has just asked if he could make a brief comment.

Mr. FROMER. I know American businessmen have to talk about farm and dairy issues. It is not the importers who are creating the stockpile problem. It has been proven over history and in studies by congressional committees and the Trade Representatives in looking at imports. It is that the wide varieties of cheese imported into this country have opened the markets for the domestic producers.

If you go to domestic cheese seminars and association meetings around the country, you notice that there is an interlocking of both the domestic manufacturer and the importer of cheese. In fact, the importers have always taken the lead in opening new markets to new people and expanding the tastes of the American consumer.

The imported cheeses constitutes less than 5 percent of the total cheese consumed in this country. They can hardly have been held to have caused the burden of the cheese stockpiled. Over the last few years, imports have gone down. Imports 3 or 4 years ago were a few million pounds, 5 percent more than they were going to be this year.

There was no cheese stockpiled a few years ago in this country. What happened is that the system—the dairy people are manufacturing more and more. Consumption isn't growing in line with that manufacturing. If you look at the dairy production, you will see that the American cheese production in this country has gone up maybe 500 or 600 million pounds in annual production amounts in the last 3 years, just far more than the country can absorb.

It is not the importers or the cheese imports that have created the problem. Yet we are the whipping boy and the excuse. The total amount of cheese is only 230 million pounds. The Government increased stocks by 600 million pounds in the last 6 years. If they let the importers have some of the things they have requested here which would enable them to broaden the variety of cheese imported into this country, you might expand the consumers marketplace the way it has been expanded and introduce 20 or 30 million consumers in this country to eat cheese and that would help eliminate some of the problems that the American domestic production is facing.

They just don't have enough people to sell the cheese to because not everybody eats cheese.

Yet, when cheese becomes fashionable, both from a social viewpoint and a consumption viewpoint, more people get introduced to it and more people consume it.

Chairman **Gibbons**. I know the imports are not the cause of the surplus. There is a market out there to be developed. If anybody wants any lesson in how to develop markets, I hate to say this, but when you can get Americans to drink as much orange juice as Floridians drink, it is hard to open a market and get the price down.

You know, I can remember as a younger person that we used to cringe when people talked about harvesting 50 million boxes of fruit in Florida.

You know, that wouldn't keep the industry running now but a few months. The people in Florida who sell oranges have just done one terrific job of convincing people that oranges are a worthwhile product. The price stays down because they keep the volume up; I don't know whether that can be done with the cheese industry, but our solution is not by trying to run prices up and restrain people's opportunities to try new things and to enjoy new things.

Mr. **Fromer**. Mr. Chairman, one of the members of this table is a preferred importer. One of the points that the president made, Mr. Steinke, in his remarks, was the unfairness of the preferred importer status which, although some of the foreign countries have designated some of the historical importers as preferred importers to reduce the hue and cry that came about when they created the situation, the preferred importers, themselves being really patriotic American businessmen, find the whole system to stink.

You might want to ask Mr. Trugman if he has comments on it. Their concern is that now today maybe the foreign governments can designate Mr. Trugman's company, for example, as a preferred company. Tomorrow they can take it away, as some countries have, and set up their own designated agents in this country.

One knows how one can control pricing and selling to the United States. From an American taxpayer's standpoint, a consumer's standpoint, they keep the prices at the level they want to keep it at and take the profit out of the country and don't pay taxes here.

This is just not the type of system we have been brought up to. It is not the type of system that our members built their businesses on. They don't like us to live under the fear of today I am the preferred importer, and tomorrow I may not be.

Chairman **Gibbons**. I would be glad to hear from you.

Mr. **Trugman**. Mr. Chairman, there are four importers sitting at the table. Three of us are named preferred importers to some extent; and yet—and our whole board of directors has all the preferred importers or most of them on it and we voted to be against this preferred import clause because it has changed the whole picture.

Actually, before the GATT regulations came into effect and the new regulation 2 years ago, 58,000 tons of cheese was imported under license. Another 50,000 were imported so-called price break cheese without licenses.

The Government saw fit to impose definite quotas on the whole import sector and we now have 58,000 tons old licenses and about 51,000 tons new licenses.

According to the regulations, and according to your committee's recommendation, these 51,000 tons should have been divided up fairly among the price break importers and the traditional importers and the new entrants. Actually, what happened is that 50 percent maximum were allocated the way you suggested it and 50 percent were to new people altogether with the provision that if a country asked the U.S. Government to certify an importer, they could nominate that importer.

The—what happened is that a maximum of 50 percent was actually allocated to category A, but from a practical point of view, it was not 50 percent; it was considerably less. We don't have the figures. We can't find that out. But on the other side, the European Community countries, the European Community, was allocated 15,000 tons out of the 51.

They did not elect on that preferred importer status. All the other countries did; and out of 36,000 tons, a minimum of 18,500 were given to these governments to nominate their importers; and what has happened is that most of these people have established their own companies or had established prior to that their own companies who now not only are their agents for selling, but are the actual importers.

Now, in certain countries such as Argentina, a situation arose which I would like to have Mr. Schumann explain, because he knows definitely. In about one moment he could do that.

Mr. **Schumann**. Mr. Chairman, my family has been involved in the importation of dairy products for 50 years. I am a third-generation importer of dairy products.

Mr. **Pease**. Would you speak into the microphone, please?

Chairman **Gibbons**. You have to get close to that mike. It is not very strong.

Mr. **Schumann**. I started to say my family has been involved in the importation of dairy products for 50 years. I am the third generation of a cheese importer. We have lived in many market situations and have been importing the product for—in this specific case in Argentina for over 40 years.

With the imposition of the preferred importer status, we found due to commercial factors a market that was essentially being played with by a government—and that is periodically or in the 3 years since the institution of preferred importers, we have had 1 year where there was a designated preferred importer, another year where there had been traditional importers that were designated preferred importers, and then this year, once again, the preferred importer that was selected by exporters.

You know as well as anybody else that in an orderly marketing of products, you have to have some form of consistency; and with this importer or preferred importer status, we found total inconsistency both on the part of the Argentine Government and we have been living under what I would consider to be onerous conditions since we have developed a market and had it basically taken away from us by legislative or—by the preferred importer status.

Mr. TRUGMAN. Mr. Chairman, out of the 51,000 tons which the importers had built up and were in business with, I would say somewhere around 17 percent, minimum, has been turned over to preferred importers. That has taken a slice out of the—our whole pie. If the imports were free and the other importers could develop their market, we would not mind.

So there is someone else in there with 17,000 tons or 20,000 tons. They have actually taken a piece of our business and given it to the foreign governments. These—the foreign governments, when they sell merchandise here, they price it according to the American market. They may sell it for 20, 30 percent less in Japan or any other market; but here they price it up right to the hilt because the American Government says you should not undercut the American market.

Therefore, all those profits are remaining outside the United States and do not pay taxes here. That is the basis in general of the preferred.

Chairman GIBBONS. Quotas have to be one of the stupidest ways of controlling international trade. They leave the profit overseas, but some of our domestic producers just don't give a damn, as long as they make theirs.

So, that is where the pressure comes from. I am sure that is what has happened here in this industry. It would happen in steel if we did the same thing or in autos or any place else.

It just runs the price up. Any other questions for the panel?

Mr. BAILEY. You are tough, Mr. Chairman. Could I ask just one question?

Chairman GIBBONS. Sure.

Mr. BAILEY. Thank you.

I had some borough officials here a couple of minutes ago who got a White House briefing on the new federalism. We were talking about a few things out there.

Chairman GIBBONS. That is the bailout California-New York plan. That is all that is. Have you seen the figures on that?

Mr. BAILEY. It amounts to a horrendous income transfer and wealth of redistribution scheme the likes of which I have never seen.

Chairman GIBBONS. To California and to New York. I don't know where they came up with that dream.

Mr. PEASE. Would the gentleman yield?

Mr. BAILEY. I yield.

Mr. PEASE. I thought it was only Democratic administrations who were accused of income redistribution.

Mr. BAILEY. The goals may sound the same. The ways may sound the same, but the means are many.

Could I ask the group here, I apologize for not being here during your testimony or the questions. So if this is redundant, bear with me. Do you have an opinion on the Federal practice of purchasing cheese and warehousing it? Do you have a position? Do you have feelings about that?

Mr. **Steinke**. We certainly do, Mr. Bailey. We are all very much affected by the U.S. program where the price of milk is supported by the purchase of storable products, one of which is cheddar cheese. We think it is—and we don't think this as cheese importers, we think this as being in the cheese industry—that it's coming pretty close to being a tragedy to have to pile up this much manufactured merchandise to support the price of milk at what is generally conceded to be an excessively high level.

Mr. **Bailey**. I think we all recognize that agricultural price supports or price support mechanisms are important. I think we all know enough about agricultural production that I hope we are enlightened enough in this country to realize we need to maintain some sort of reliable supply; but you think it is overdone.

That sounds like that is about what you just said. I am sure you don't have a radical approach? How much is too much if you quantify it?

Mr. **Steinke**. We got ourselves into trouble 3 years ago—actually 4 years ago when—this may sound—this is not the place to be critical of Congress, I expect.

Mr. **Bailey**. Why not?

I haven't found a place in this country that is not the place to be critical of Congress. You go right ahead.

Mr. **Steinke**. There was a point at which time Congress set down a very firm declaration that the price of milk at the farm should be supported at 80-percent parity. We can argue all day whether parity is a good formula to use, but I don't think anybody will argue any more whether 80 percent was the right figure or not.

It may have been exactly right at one point in time. There have been times when the price of milk was higher than 80 percent, and no surplus occurred. On the other hand, by fixing it at 80 percent, and with the very, very favorable feed prices, things of that nature that American dairy farmers had, they are some of the smartest economists there are.

Every farmer knows exactly when he should start milking more and stop milking. It all depends upon his milk check. It doesn't depend on anything else.

When we set that 80 percent in concrete down here, that was a green light for every farmer that has milk cows to keep on milking and put on more. It just created a terrible surplus.

Mr. **Bailey**. You are not saying that an administration recommendation to cut back the 76 or 77 percent, if I remember right—I think that was their parity recommendation. I remember the forgoing of a 6-percent increase from 76, I believe, to 82 percent parity level in April was forgone. You mean that wasn't a great sacrifice?

Mr. **Steinke**. No, sir, it was not. There are times when milk prices were at 85 and 90 percent of parity when farmers were making less money perhundred weight of milk because their expenses were relatively higher.

There are other times when milk prices can be at 75 percent of parity where a dairy farmer can have a very profitable enterprise. Parity is not a magic formula. It is very flawed, very badly flawed.

I think the new farm bill is more on the track. Many of us in the domestic milk industry think that the price still should not have been set rigidly.

Mr. **Bailey**. They don't sell peanut cheese, do they?

Mr. **Steinke**. No.

Mr. **Bailey**. That might be a product you want to look at.

Mr. **Steinke**. There are people who make peanut butter and cheese sandwiches in large quantities.

Mr. **Bailey**. Thank you very much.

Incidentally, I thank you for the opinion.

Thank you, Mr. Chairman.

Chairman **Gibbons**. Thank you very much, gentlemen.

Our next witness is Doreen L. Brown, president, Consumers for World Trade, accompanied by Philip H. Trezise and Fred Sanderson of the board of directors, Consumers for World Trade.

STATEMENT OF DOREEN L. BROWN, PRESIDENT, CONSUMERS FOR WORLD TRADE, ACCOMPANIED BY PHILIP H. TREZISE AND FRED SANDERSON OF THE BOARD OF DIRECTORS

Ms. **Brown**. Mr. Chairman, we have prepared a summary of our recommendations at the front of the testimony.

I would like to read an abbreviated text of the testimony.

Chairman **Gibbons**. Certainly. Without objection, your full statement will be placed in the record.

Ms. **Brown**. Consumers for World Trade is encouraged by this administration's avowed commitment to a liberal trade policy.

We hope the Congress will support this policy by withstanding protectionist pressures and opposing bills which would establish barriers to the flow of international commerce.

American consumers are aware of the inflationary impact of trade restrictions. It is important for them in these economically strained times to have the freedom of choice necessary to purchase the product which meets their needs at the best possible price.

CWT recognizes that the United States must export in order to pay for its imports and therefore supports measures designed to remove artificial impediments and disincentives, two-price systems or other artificial means of stimulating exports that could not otherwise compete in the world market.

Agriculture. No economic sector has a greater stake in free and unimpeded trade than American agriculture.

Agricultural exports, currently running at $45 billion, employ one-third of our cropland and pay for one-half of our oil imports. Yet we continue to maintain severe import restrictions to shelter some agricultural producers and processors against legitimate foreign competition in the rare instances where foreign suppliers can produce at lower costs.

In some cases we afford protection to domestic producers where it is not needed at all.

Examples of protectionist legislation that is unnecessary and, ultimately counterproductive, are the sugar and peanut provisions of the 1981 Farm Act. The sugar legislation has already necessitated the tripling of import charges to 5 cents a pound.

In our view this legislation compounds the errors of past legislation which has always saddled the American consumer with high domestic prices when world market prices are low, without protecting him from very high prices in periods of world shortage.

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Clearly a more basic solution is required.

CWT also regrets the failure of the legislation to do away with the restrictions on domestic marketings and imports of peanuts; instead, the bill raised the support price for domestic sales by 20 percent. The existing two-price system not only discriminates against the consumer but, in effect, requires him to subsidize peanut exports.

There is no justification for continued protection of the U.S. peanut industry. Production increased from 2.5 to 4.0 billion pounds in the 1970's, almost entirely because of increased yields per acre, and exports tripled.

This performance strongly suggests that U.S. producers could compete in the world market without government assistance, controls and protection.

Textiles and apparel. The U.S. textile and apparel industries have had 25 years of quota protection plus the highest level of tariff protection of any U.S. industry.

It has been estimated that tariffs on apparel imports cost consumers $2.7 billion a year and quotas $370 million a year for each textile job protected.

These figures come from a CWPS study made in 1979 and some of the more restrictive bilateral agreements between the United States and the exporting countries have further increased these impact figures.

The extension of the Multifiber Arrangement agreed to in Geneva on December 22, 1981, could prove to be more restrictive than prior MFA's and bring about additional economic burdens to the consumer.

CWT hopes that the administration and Congress and the industry will consider this the last of the multifiber arrangements and will ease the import restraints on textiles and apparel.

Tight restrictions mean higher prices for American consumers as foreign suppliers are likely to reserve their shrinking quotas for their most profitable, higher priced lines.

Tighter restrictions would harm our exports of agricultural and manufactured products to developing countries that depend on textile and apparel exports as a principal source of foreign exchange.

Steel. The American steel industry has had import protection over and above tariffs since 1968, except for an interval in the middle 1970's. Protection has not brought about new investment or strengthened the industry's long-term competitive prospects.

It has raised the costs of American steel users, including users in export industries, to the disadvantage of American consumers and the national economy.

A new study of the U.S. steel industry by Robert W. Crandall, published by the Brookings Institution—the U.S. Steel Industry in Recurrent Crisis, Policy Options in a Competitive World—concludes that import restrictions cannot be effective in restoring the international competitive position of the American steel industry.

Crandall suggests that the solution lies in the retirement of that part of present capacity that is especially vulnerable to foreign competition.

Scrap-based minimills will offset part of that decline.

Once the retrenchment is complete, the industry may enter a stable period of limited growth. Any attempt to forestall this development through trade protection would only accelerate the decline of the steel-fabricating industries, many of which are already in trouble.

Crandall estimates the cost to the consumer of the TPM at $1.25 billion in 1979. A much higher level of trade protection, at a cost to consumers of at least $3.5 billion annually would be required before the building of new capacity would become commercially feasible.

But high construction and operating costs would make the new capacity critically dependent on continuing protection or subsidization.

CWT believes that the TPM can and should be abandoned, allowing our steel fabricating industries to have the benefits of access to a free market for their basic material inputs.

As for foreign dumping and/or subsidies, CWT observes that these are matters covered by statute.

CWT supports the enforcement of American law by the agencies charged with that responsibility, in this case the executive branch, and the ITC.

As for automobiles, CWT opposed restrictions on automobile imports, including the supposedly voluntary restrictions that the Japanese industry has been applying since last year.

We expected the consumer to be the ultimate loser and we doubted that the American industry would benefit. Nothing has happened to change our views.

The consumer's response to higher prices and high interest rates has been to postpone buying automobiles. The domestic industry obviously is suffering in this depressed market. Its recovery, however, depends on recovery of the economy, which in turn depends in part on lower interest rates.

Further import restrictions are not a solution. They will lead only to higher prices and continued consumer resistance.

CWT would prefer that this ill-advised and hypocriticial arrangement be discontinued.

If that is not done, CWT believes that the restraint limit should be raised, and originally agreed to allow imports to compete more freely in the rising market that is expected in the fall and winter of 1982–83.

We certainly would oppose any effort to coerce the Japanese into reducing the 1.68 million unit established under the 1981 understanding.

We now have a trade agenda for 1982. I would highlight some of our particularly greater concerns for 1982:

CWT supports and urges House passage of the Export Trade Act of 1981, the LaFalce/Gibbons Act, a bill to promote the formation of export trading companies which we believe will encourage small firms to enter the world market without subsidies.

We also support the Foreign Corrupt Practices Act amendments introduced by Congressman Rinaldo, a bill to clarify the FCPA, which acts as an export disincentive because of its ambiguities. FCPA has resulted in unintended side effects and inequities which have been cause enough for Congress to consider amendments to the legislation.

Services. World trade in services has been estimated at $400 billion, roughly one-sixth of total trade in goods and services.

We are pleased that the administration intends to pursue the question of an eventual international negotiation in this field.

Our impression is that the necessary data collection and analytical work for such a negotiation are still in a relatively preliminary stage. We hope that Ambassador Brock and the executive departments concerned will press forward on the services problem and will be able to bring it up for discussion at the General Agreement on Tariffs and Trade ministerial meeting scheduled for November of this year.

Services now account for roughly two-thirds of our GNP and 70 percent of all jobs in the United States.

The administration is correct and timely in addressing the challenge to our favorable services trade position. Consumers, both here and abroad, stand to gain if the restrictions are removed or reduced.

In the area of reciprocity, this so far ill-defined idea seems to call for equality of trade opportunities between the United States and its trading partners, with equality to be measured by bilateral trade results.

CWT supports equal access to foreign markets for U.S. exporters and to the American market for foreign exporters. This is an essential principle of the GATT and of sensible trade policy.

CWT does not believe that equal opportunity can be enforced by unilateral trade restrictions on our part, as has been suggested by some congressional and administration figures.

Every country maintains restrictions on imports, including the United States.

Where these do not square with the GATT, we and other GATT parties have rights to redress. Or, if we feel that GATT procedures are too slow, we can enter into discussions and negotiations with our trading partners, as is now the case with Japan. CWT does not believe that foreign trade restrictions are any more or less defensible than American trade restrictions.

But the assertion of a unilateral right to retaliate against another country's alleged trade barriers will (a) give American officials, bureaucrats, powers over the interests of our importers and consumers that the Congress and the administration ought to resist on principle, and (b) expose American industries to counter-retaliation.

In fact, unilateralism and a simple-minded insistence on bilateral balancing can only degrade the trading system and threaten the gains we have made toward openness in trade over the past 30 years.

There is no present crisis in trade, despite the rhetoric.

The United States ran a substantial surplus in its overseas transactions last year. It happens to have been larger than Japan's global surplus. It is the responsibility of the Congress and the administration to sort out the realities in this field and to pursue a steady but prudent course toward more trade, not less.

In summary, CWT is making the following recommendations for U.S. trade policy in 1982 and ensuing years:

One. Reform of U.S. agricultural policy with a view to the elimination of import restrictions and unnecessary protection for domestic producers.

Two. Gradual liberalization and eventual elimination of import restraints on textiles and apparel.

Three. Elimination of the trigger price mechanism and the use of existing U.S. statutes and legal mechanisms to correct inequities in international steel trade.

Four. Lifting or easing of restraints on auto imports from Japan.

Five. Reduction of barriers, establishment of rules and enforcement mechanisms for international trade in services.

Six. Passage of the Export Trade Act of 1981 and the bill to clarify the Foreign Corrupt Practices Act.

Seven. Efforts to achieve equal access to foreign markets by means which will result in open and expanded trade, rather than by the precipitous and dangerous adoption of a reciprocity policy.

CWT is very concerned about the intensified calls for protectionism emanating from both the private and public sector.

We urge Congress to keep in mind the devastating consequences of a trade war and to continue to seek ways to insure a free flow of international commerce.

This completes our testimony, Mr. Chairman.

My colleagues, who are directors of CWT, will be glad to answer any questions.

[The prepared statement follows:]

STATEMENT OF CONSUMERS FOR WORLD TRADE

Consumers for World Trade (CWT) is a national, nonprofit, membership organization, established in 1978. CWT supports expanded foreign trade to help promote healthy economic growth; provide choices in the marketplace for consumers; and counteract inflationary price increases. CWT believes in the importance of increasing productivity through the efficient utilization of human and capital resources. CWT conducts its educational programs to keep American consumers informed of their stake in international trade policy and speaks out for the interests of consumers when trade policy is being formulated.

SUMMARY

In summary, Consumers for World Trade (CWT) is making the following recommendations for U.S. trade policy in 1982 and ensuing years:

(1) Reform of U.S. agricultural policy with a view to the elimination of import restrictions and unnecessary protection for domestic producers.

(2) Gradual liberalization and eventual elimination of import restraints on textiles and apparel.

(3) Elimination of the Trigger Price Mechanism and the use of existing U.S. statutes and legal mechanisms to correct inequities in international steel trade.

(4) Lifting or easing of restraints on auto imports from Japan.

(5) Reduction of barriers, establishment of rules and enforcement mechanisms for international trade in services.

(6) Passage of the Export Trade Act of 1981 (H.R. 1648) and the bill to clarify the Foreign Corrupt Practices Act (H.R. 2530).

(7) Efforts to achieve equal access to foreign markets by means which will result in open and expanded trade, rather than by the precipitous and dangerous adoption of a "reciprocity" policy.

An open, expanding and competitive world trading system is essential to the economic welfare of the American consumer, and is of benefit to our national economy. CWT is very concerned about the intensified calls for protectionism emanating from both the private and public sector. We urge Congress to keep in mind the devastating consequences of a trade war and to continue to seek ways to ensure a free flow of international commerce.

Consumers for World Trade (CWT) welcomes this opportunity to express its views on current U.S. trade policy as it affects the American consumer, and to review some of the issues that are of major concern to the organization.

CWT is encouraged by this Administration's avowed commitment to a liberal trade policy. We hope that Congress will support this policy by withstanding protectionist pressures and opposing bills which would establish barriers to the flow of international commerce. Experience has shown that protectionist measures benefit neither industry nor the public, and can lead to retaliatory measures which perpetuate the barriers to open trade.

American consumers have a substantial stake in trade policy. They are aware of the inflationary impact of trade restrictions. It is important for them, in these economically strained times, to have the freedom of choice necessary to purchase the product which meets their needs at the best possible price. Restrictions on imports, whether by high tariffs, quotas, or other nontariff barriers, result in higher costs for both the foreign product and the comparable domestic product. The elderly, the retirees, the fixed income and low income people in our population suffer the most. Import restrictions force American consumers as well as our efficient domestic industries to subsidize those industries that have not remained competitive.

CWT recognizes that the United States must export in order to pay for its imports. Exports benefit the consumer by strengthening the dollar and thus lowering the prices of both imports and domestic products. Exports enable us to make more efficient use of our resources. They create employment opportunities and foster greater productivity. By creating a healthier economic environment, they tend to reduce protectionist and anti-competitive pressures. These are some of the reasons why CWT supports measures designed to remove artificial impediments and disincentives to our exports. However, we do not favor export subsidies, tax incentives, two-price systems or other artificial means of stimulating exports that could not otherwise compete in the world market.

ASSESSMENT OF 1981 ACTIONS AND POLICIES

Agriculture.—No economic sector has a greater stake in free and unimpeded trade than American agriculture. Agricultural exports, currently running at 45 billion dollars, employ one-third of our crop land and pay for half of our oil imports. Yet we continue to maintain severe import restrictions to shelter some agricultural producers and processors against legitimate foreign competition in the rare instances where foreign suppliers can produce at lower costs. In some cases, we afford protection to domestic producers where it is not needed at all, for example, where our producers can demonstrably compete in the world market, or where they could readily shift to more competitive lines of production.

Examples of protectionist legislation that is unnecessary and, ultimately counterproductive are the sugar and peanut provisions of the 1981 Farm Act. The sugar legislation has already necessitated the tripling of import charges to 5 cents a pound.

In our view, this legislation compounds the errors of past legislation which have always saddled the American consumer with high domestic prices when world market prices are low, without protecting him from very high prices in periods of world shortage. Furthermore, high sugar prices have exposed American sugar growers to increased competition from corn sweeteners. CWT opposed the enactment of a quick-fix for this largely self-inflicted problem at the expenses of the American consumer by increasing his cost for both sugar and sugar substitutes by over 1.5 billion dollars. Clearly, a more basic solution is required.

CWT also regrets the failure of the legislation to do away with the restrictions on domestic marketings and imports of peanuts; instead, the bill raised the support price for domestic sales by 20 percent. The existing two-price system not only discriminates against the consumer but, in effect, requires him to subsidize peanut exports. There is no justification for continued protection of the U.S. peanut industry. Production increased from 2.5 to 4 billion pounds in the 1970's (almost entirely because of increased yields per acre) and exports tripled. This performance strongly suggests that U.S. producers could compete in the world market without government assistance, controls and protection.

CWT has been gratified, on the other hand, by the International Trade Commission's finding against restrictions on imports of tobacco and casein. We hope that this will settle the matter.

Textiles and apparel.—The U.S. textile and apparel industries have had 25 years of quota protection plus the highest level of tariff protection of any U.S. industry. These restrictions have raised the cost of clothing to the consumer substantially. It has been estimated that tariffs on apparel imports cost consumers 2.7 billion dollars a year and quotas 370 million dollars a year for each textile job protected (Council on Wage and Price Stability—Study, 1979). Later, more restrictive bilateral agreements between the U.S. and the exporting countries have further increased these impact figures.

The extension of the Multifiber Arrangement (MFA) agreed to in Geneva on December 22, 1981 could prove to be more restrictive than prior MFAs and bring about additional economic burdens to the consumer. It opens the door to bilateral agreements that would further narrow the scope for shifting quotas in response to change in fashions or consumer tastes.

CWT hopes that the Administration and Congress and the Industry will consider this the last of the Multifiber Arrangements and will ease the import restraints on textiles and apparel. Tight restrictions mean higher prices for American consumers as foreign suppliers are likely to reserve their shrinking quotas for their most profitable, higher-priced lines. Tighter restrictions would harm our exports of agricultural and manufactured products to developing countries that depend on textile and apparel exports as a principal source of foreign exchange.

Steel.—The American steel industry has had import protection, over and above tariffs, since 1968, except for an interval in the middle 1970s. Protection has not brought about new investment or strengthened the industry's long term competitive prospects. It has raised the costs of American steel users, including users in export industries, to the disadvantage of American consumers and the national economy. It has also conferred benefits on foreign exporters of steel, who received higher returns than would have been possible in a free market.

A new study of the U.S. steel industry, by Robert W. Crandall, published by the Brookings Institution (The U.S. Steel Industry in Recurrent Crisis, Policy Options in a Competitive World, Brookings, 1981) concludes that import restrictions cannot be effective in restoring the international competitive position of the American steel industry. Crandall suggests that the solution lies in the retirement of that part of present capacity that is especially vulnerable to foreign competition. Scrap-based mini-mills will offset part of that decline. Once the retrenchment is complete, the industry may enter a stable period of limited growth. Any attempt to forestall this development through trade protection would only accelerate the decline of the steel-fabricating industries, many of which are already in trouble.

Crandall estimates the cost to the consumer of the Trigger Price Mechanism at 1.25 billion dollars in 1979. A much higher level of trade protection, at a cost to consumers of at least 3.5 billion dollars annually, would be required before the building of new capacity would become commercially feasible. But high construction and operating costs would make the new capacity critically dependent on continuing protection or subsidization. CWT believes that the Trigger Price Mechanism can and should be abandoned, allowing our steel fabricating industries to have the benefits of access to a free market for their basic material inputs.

As for foreign dumping and/or subsidies, CWT observes that these are matters covered by statute. CWT notes that the subsidy cases relate to only a portion of our suppliers. The Executive Branch is investigating the subsidy allegations under established procedures and the International Trade Commission is examining the question of injury. CWT supports the enforcement of American law by the agencies charged with that responsibility.

Autos.—CWT opposed restrictions on automobile imports, including the supposedly voluntary restrictions that the Japanese industry has been applying since last year. We expected the consumer to be the ultimate loser and we doubted that the American industry would benefit. Nothing has happened to change our views. Domestic auto prices have risen sharply. Japanese producers, it seems, have moved their exports so far as possible into higher value cars so as to maintain earnings from a lower volume of sales in the United States.

The consumer's response to higher prices and high interest rates has been to postpone buying automobiles. The domestic industry obviously is suffering in this depressed market. Its recovery, however, depends on recovery of the economy, which in turn depends in part on lower interest rates. Further import restrictions are not a solution. They will lead only to higher prices and continued consumer resistance.

We understand that the Japanese industry's so-called voluntary restraints are to go on for one more year. CWT would prefer that this ill-advised and hypocritical arrangement be discontinued. If that is not done, CWT believes that the restraint limit should be raised, and originally agreed, to allow imports to compete more freely in the rising market that is expected in the fall and winter of 1982-83. We certainly would oppose any effort to coerce the Japanese into reducing the 1.68 million unit established under the 1981 understanding.

TRADE AGENDA FOR 1982

Export trading companies.—CWT supports H.R. 1648, LaFalce (D-NY)-Gibbons (D-FL)—the Export Trade Act of 1981, a bill to promote the formation of export trading companies which we believe will encourage small firms to enter the world market without subsidies.

Foreign corrupt practices act (FCPA).—CWT supports H.R. 2530, introduced by Congressman Rinaldo (R-NJ), a bill to clarify the FCPA, which acts as an export disincentive because of its ambiguities. FCPA has resulted in unintended side effects and inequities which have been cause enough for Congress to consider amendments to the legislation.

CWT urges House passage of H.R. 2530 thereby eliminating export disincentives that prohibit increased productivity which is beneficial to the domestic industry, the national economy, and the consumer.

Services.—World trade in services has been estimated at 400 billion dollars, roughly one-sixth of total trade in goods and services. We are pleased that the Administration intends to pursue the question of an eventual international negotiation in this field.

Our impression is that the necessary data collection and analytical work for such a negotiation are still in a relatively preliminary stage. We hope that Ambassador Brock and the executive departments concerned will press forward on the services problem and will be able to bring it up for discussion at the General Agreement on Tariffs and Trade (GATT) ministerial meeting scheduled for November of next year.

We will support initiatives for reducing barriers, establishing rules and enforcement mechanisms for international trade in services. Services now account for roughly two-thirds of our GNP and seventy percent of all jobs in the United States. They also account for a large and positive contribution to our balance of payments. Competition from abroad, however, is increasing, as is concern about foreign barriers to U.S. trade. The Administration is correct and timely in addressing the challenge to our favorable services trade position. Consumers both here and abroad stand to gain if the restrictions are removed or reduced.

Reciprocity.—This so far ill-defined idea seems to call for equality of trade opportunities between the U.S. and its trading partners, with "equality" to be measured by bilateral trade results. CWT supports equal access to foreign markets for U.S. exporters and to the American market for foreign exporters. This is an essential principle of the GATT and of sensible trade policy.

CWT does not believe that equal opportunity can be enforced by unilateral trade restrictions on our part, as has been suggested by some Congressional and Administration figures. Every country maintains restrictions on imports, including the United States. Where these do not square with the GATT, we and other GATT parties have rights to redress. Or, if we feel that GATT procedures are too slow, we can enter into discussions and negotiations with our trading partners, as is now the case with Japan. CWT does not believe that foreign trade restrictions are any more or less defensible than American trade restrictions.

But the assertion of a unilateral right to retaliate against another country's alleged trade barriers will (a) give American officials—bureaucrats—powers over the interests of our importers and consumers that the Congress and the Administration ought to resist on principle, and (b) expose American industries to counter-retaliation.

To bring the retaliation question into focus, consider the case of the European commercial air liner, the Air Bus. By all accounts, the Air Bus is an excellent aircraft, competitive with comparable American planes. We have no visible barriers to imports of commercial air liners. Yet the European consortium that has produced the Air Bus has had minimum success in selling the plane to our air carriers. The reasons for this no doubt are understandable on strictly business terms. But if we begin measuring reciprocity in access by sales results in other categories of goods, why should the Europeans not do the same with respect to aircraft?

In fact, unilateralism and a simple-minded insistence on bilateral balancing can only degrade the trading system and threaten the gains we have made toward openness in trade over the past 30 years. There is no present crisis in trade, despite the rhetoric. The United States ran a modest surplus in its overseas transactions last year. It happens to have been of just about the same dimensions as Japan's global surplus. It is the responsibility of the Congress and the Administration to sort out the realities in this field and to pursue a steady but prudent course toward more trade, not less.

In summary, CWT is making the following recommendations for U.S. trade policy in 1982 and ensuing years:

(1) Reform of U.S. agricultural policy with a view to the elimination of import restrictions and unnecessary protection for domestic producers.

(2) Gradual liberalization and eventual elimination of import restraints on textiles and apparel.

(3) Elimination of the Trigger Price Mechanism and the use of existing U.S. statutes and legal mechanisms to correct inequities in international steel trade.

(4) Lifting or easing of restraints on auto imports from Japan.

(5) Reduction of barriers, establishment of rules and enforcement mechanisms for international trade in services.

(6) Passage of the Export Trade Act of 1981 (H.R. 1648) and the bill to clarify the Foreign Corrupt Practices Act (H.R. 2530).

(7) Efforts to achieve equal access to foreign markets by means which will result in open and expanded trade, rather than by the precipitous and dangerous adoption of a "reciprocity" policy.

CONCLUSION

An open, expanding and competitive world trading system is essential to the economic welfare of the American consumer, and is of benefit to our national economy. CWT is very concerned about the intensified calls for protectionism emanating from both the private and public sector. We urge Congress to keep in mind the devastating consequences of a trade war and to continue to seek ways to ensure a free flow of international commerce.

Chairman **Gibbons**. Thank you very much for your very constructive statement.

Mr. Bailey?

Mr. **Bailey**. Thank you, Mr. Chairman.

Well, I don't know how long you have been here. You know that we may not see eye to eye on a few things. The volume is down today, so I will try to speak up.

I think on reciprocity, I will leave that for my colleague from Pennsylvania, Mr. Schulze, who I think will address that.

Let me ask you a few questions. What is the nature of your membership? Do you have any members from Japan?

Ms. **Brown**. No; we have American members only.

Mr. **Bailey**. You don't have any European or Japanese members?

Ms. **Brown**. No, sir.

Mr. **Bailey**. You mentioned dumping. Do you think antidumping or countervailing duty laws are good things?

Do you think the theory or the idea in—the idea in theory or in practice of antidumping or countervailing duty laws are good things?

You mentioned them in your statement.

Mr. **Trezise**. They are on the books as Ms. Brown says. We support the enforcement of American laws.

Mr. **Bailey**. Do you think they are a good idea? Do you think they are necessary?

Mr. **Trezise**. No.

Mr. **Bailey**. You seem to talk about unilateralism on one hand, that it is good to tear barriers down.

I wonder if we can have our cake and eat it too. You seem to be against it on the other. You don't want them set up.

What do you do? How do you respond to a problem where another country targets one of your industries, what do you folks do in the real world about a problem like that?

I would love things to be the way you say. We don't operate under the same laws, the same tax codes here, as we do overseas. I think on balance the American response to trade has been probably as open as any country as I know of on balance. It can't be perfect.

What are we supposed to do? You are not for unilateral disarmament, I wouldn't imagine, in the military area?

That would not appeal to you, would it?

Mr. TREZISE. Congressman, I do not know of any country that targets American industries. If countries choose to use their taxpayers' money and resources to give our consumers lower prices, that is to the benefit of our consumers. We are here testifying on behalf of the American consumer, but you ask what can we do about trade restrictions abroad.

We have rights under the GATT. We can exercise those rights.

Mr. BAILEY. You told me you thought we ought to do away with some of those things.

Mr. TREZISE. Ms. Brown said that we oppose restrictions based on our unilateral definition of what other people are doing.

It is a simple proposition in international affairs that we are not likely to get away with it.

Mr. BAILEY. If you are signatory to an agreement like the GATT and you decide that you don't like subsidies, for example, then you put in place some kind of machinery or you have some type of domestic response by law, regulation, et cetera, within the agreement to allow you to effectuate those policies.

I would very gently say to you that that is a realm that countervailing duties and antidumping statutes step into. They attempt to—and they are consistent with the GATT. I know the theoretic thing you say. I guess there is no use to—I see a different world in real terms, I guess, than you do.

I don't want to sound harassing. I just think that you are a little unrealistic.

Mr. TREZISE. Congressman——

Mr. BAILEY. I disagree with you.

Mr. TREZISE. Our statutes do conform with the GATT. That I think is not only desirable, but necessary.

Mr. BAILEY. So do our practices by and large, much more so than some of our competitors.

Mr. TREZISE. That may be true as well. You asked me for a personal opinion about the dumping and countervailing duty statutes. I didn't say whether they conform with the GATT or not.

Mr. BAILEY. I did not ask you for a personal opinion. I was curious what your organization said. I lost my train of thought on a question I wanted to ask

What happens when the Japanese for example, I don't think they necessarily target us. I do think they target world markets by and large and protect domestic markets in order to get them into a competitive position to do that.

At least that has been their practice in some cases.

I wanted to ask you, do you view a nation's tax policy, her domestic policy, any nation's domestic policy as part of this formula on free trade?

In other words, let's say the way and manner in which a nation taxes her capital or the way in which a nation, for example—you didn't mention anything here about subsidizing finance packages. Would you say that is not a good thing to do?

In other words—and no country should be as part of its business relationship—it shouldn't be financing, I suppose, exports. You could be against that, would you not?

Mr. **Trezise**. Congressman, you have to be a bit more specific as to what tax provision you are talking about.

Mr. **Bailey**. How do you feel about the Export-Import Bank?

Mr. **Trezise**. Export subsidies?

Mr. **Bailey**. No. You know what the Export-Import Bank is that we have? In this country?

Mr. **Trezise**. Surely.

Mr. **Bailey**. I assume you do. How do you feel about it?

Mr. **Trezise**. I think it is asking the taxpayer to provide other countries, other purchasers in other countries, including the Soviet Union, I might say, with goods at below market price, below full market price.

I think it is a crazy idea. I wish we could do away with it.

Mr. **Bailey**. Let me say this to you and I will conclude.

I think the goals you want to achieve are goals that everybody, including myself—and I mean this from the bottom of my heart—wants to achieve.

I just think that writing policy or sitting where I have to sit, I have to look at a lot of things like the Nation's military security, for example. The comparative advantage which I suppose is really at the base of what you folks are talking about is a great academic and a great historic and a very realistic goal we should work towards.

But everybody doesn't do business the way we do, and we don't do it perfectly.

I agree with that, by the way. I can't defend everything we do, but I just think that what you are talking about is just completely unrealistic.

I feel duty bound to say that to you. I don't mean to offend you by saying this. You talk about the steel industry. It is just not quite fair. Some of your criticisms I think are valued. Some are not. We have downstream dumping problems where there are unquestionably things we would internally call monopolistic or antitrust practices that would violate everything we believe in about free competition.

Part of the comparative advantage has something to do with reasonable competition and market—equal access to markets and things like that. That is a very important part of that idea, that beautiful little gem.

Geez, if you call those kinds of practices that we see in marketing Japanese products here in that narrow a vein, I don't think we do disagree much about—or do agree very much about these problems.

You want to comment. Then I am finished, Mr. Chairman.

Ms. **Brown**. The only comment I have, Congressman, concerns your appreciation of the fact that what we may be supporting is an idealistic trade policy. I don't think it is.

I think it is one that is realistic.

Mr. **Bailey**. I don't mean it that way. Let me be more harsh then. I think you are being horribly hypocritical. That is what I think. I think that your goals are fine and the ideals are great, but I don't think other countries—I don't think we can do these things unilaterally.

I hope we can accomplish them through negotiation. I agree with you in that regard. That is how I feel.

Ms. **Brown**. You do agree then, that the way to get closer to these goals is not by reawakening protectionism in this country the way we had it in the thirties?

Mr. **Bailey**. Madam, with all due respect, I could not find it within my conscience to go to my taxpayers and tell them that the United States of America should gamble on the responsibilities that you are recommending to me that we take. I think if I went to them with that I hope they would have the good sense to beat me in the butt right out of office.

Ms. **Brown**. Would you go to them, Congressman, and say to them that we are taking the gamble of going backward to the post Smoot-Hawley legislation era?

Mr. **Bailey**. I am very much aware of this Nation's relative position in the world. I think we are very, very powerful, but I think we are being very unwise on how we exercise that leadership.

I think that the United States of America has an opportunity to decide and direct the development of what I think is the future of this world. That is free enterprise. I really mean that.

I think those creaky totalitarian economies are just shriveling up.

I want to see a free world. I want to see us lead it. If we have to be tough doing that, I think we ought to.

I think the stupidest damned thing we can do is sit around and let ourselves be victimized.

If you want to see a protectionist backlash, all we have to do is hand all this nonsense to the Japanese in the name of some of the things you are talking about without teaching them a lesson.

That is, when you play, you have to play fair and play by standard rules because if we don't, Karl Marx is going to end up being right, not because he was or knew any better or Hegelian dialectics had any application to world history, but we are going to get into big trade wars.

I think we have to do these things in a general kind of way worldwide. We have to work them down, develop tax structures, investment opportunities, market entry conditions, and what-not that are fair. If you think downstream dumping represents some kind of a fair way to respond to America's steel problems, I think that is crazy.

I recently was on the Armed Services Committee. We wanted to get materials for a tank, and couldn't do that, couldn't get the materials for it because they were not made in this country for a certain item on that tank.

Most of the glass that was being sold in this country that was supplanted was a glass that had been sold here by subsidized industries below cost.

I could document the whole history of that industry for you. I am taking too much time.

Thank you, Mr. Chairman.

Chairman GIBBONS. Mr. Schulze?

Mr. SCHULZE. Thank you, Mr. Chairman.

I don't want to continue in this vein for too long, but in your statement, Ms. Brown, it says "experience has shown that protectionist measures benefit neither industry nor the public."

When I look at the Japanese example, I have to disagree with that. I think that they, through very extreme protectionist measures, have had their own citizens subsidize the developmental phase of industries and then penetrated very deeply our and other markets around the world without a great deal of retaliation.

In my opinion, it is sort of a classic example of using protectionism to build and penetrate. I wonder if you disagree with that?

Ms. BROWN. I am afraid I didn't hear the last of your sentence.

Mr. SCHULZE. The last of my sentence was that it seems to me it is a classic example of a country using protectionism to build an industry and then penetrate world markets.

Every time there has been the threat of retaliation, they have eased just a little bit, just enough to placate those who have been perhaps suffering a little bit.

I think it really is a textbook example of using protectionism to the *n*th degree to build the country's economy.

Ms. BROWN. I will turn this question over to Mr. Trezise in a moment, but I think it is a matter of not only interpretation, but really a matter of fact. I would like somebody to actually come forth and produce for my own benefit, for my organization's benefit, absolute facts about Japan's protectionism. We hear of cultural problems on the one hand. We hear of distribution differences on the other and so on.

Mr. SCHULZE. Didn't we have a perfect example of that when they just announced they were going to eliminate 67 of the 99 most damaging nontariff barriers last week?

If those barriers were not there and they were not fully cognizant of them, they would not at this point suddenly say, we are going to eliminate 67 of them.

Ms. BROWN. I think there are more reasons than trade for a lot of the decisions made in the trade field.

Mr. SCHULZE. There was an overall picture though.

Ms. BROWN. I am not defending Japan. That is not our interest at all.

Mr. SCHULZE. I think they have used protectionism in a classic way. I think in future years countries are going to look at that and study it and emulate that example as a way to build a sound industrial base.

Ms. BROWN. It did not work for us though.

Mr. SCHULZE. Just for a second if we can go to—if you want to, to Smoot-Hawley. I disagree with those scholars who say Smoot-Hawley caused the depression. It may have had a tiny impact on it or some impact, but there were many other financial and economic ramifications; England going off the gold standard; other things, which I think had a ripple effect around the world which had much greater impact.

Ms. **Brown**. May I say one other thing? Protectionism in this country to me has proved itself a failure by the fact that the textile industry, which has been heavily and long-term protected, is according to the textile and apparel industry, not doing any better and is requiring more protection.

The steel industry is doing exactly the same thing. Somewhere along the line the medicine must be wrong.

If the illness is really there, the medicine must be wrong. If, after all these years, the longer an industry is protected, the longer it requires protection, protectionism is not benefiting the industry.

Mr. **Schulze**. That also depends upon the economic structure of the country.

If you have a little tighter governmental control and say it is governmental policy to develop a certain industry and do it with the forethought of penetrating certain markets, I think it can be very successful. We don't have that type of economy and as a consequence, we have been unable to put forth a sound coherent policy and follow through in that manner. In an ideal world I would love to accept your statement and say Hallelujah, let's do it. But I constantly see examples where we have been trying to develop a free market open trade policy throughout the world with little success.

Countries—most countries of the world do what is in their best interests, period.

We, I think, perhaps through some sort of guilt complex, have felt we are the largest, richest nation in the world. As a consequence, we have to absorb some of this unemployment, perhaps, or subsidization from other countries. But there is a point beyond which you cannot do that. I think that——

Ms. **Brown**. I personally doubt the United States has done much in the trade field for the sake of other countries. To my mind that may be one of the prime problems.

Mr. **Schulze**. I know there are other people who would like to ask questions. I would be happy to yield.

Mr. **Bailey**. Just to give you very, very quick examples of Japanese—you said you haven't seen any examples of Japanese protectionism.

I haven't seen anybody that would seriously deny. You are the first person I have heard who can't understand or doesn't see some of the Japanese policies that have evolved that way.

Two very, very quick examples: Their preferential treatment under tax law in Japan for specific industries to allow them to develop while at the same time maintaining opposition to foreign imports. They had an experience, for example, with Korean steel, which could undersell Japanese steel by about 10 percent in the Japanese domestic market. It was denied entry.

The second example is on geothermal power projects. This I have personal knowledge of.

A finance package of advantages were given to Third World countries. One was Indonesia, for example, where the financial package was subsidized and, in fact, no one questioned the fact that inferior technology was accepted by the Third World country simply because the financial package was so much cheaper.

For large projects, that is a very important part of it.

We just had a jawboning problem with them, as you know, in telecommunications equipment. You can't be blind to those things. I am not saying it is right. All I am saying is, when we do these things, we have to do them in a perspective where there is balance to it.

I think what Mr. Schulze said is right. I am not saying it is the best way to proceed. Sometimes you don't have much choice. I can go on and on with Europe and the steel industry downstream dumping and fabricated products. You mentioned them in your testimony. You know what happens there. You know what occurs.

They sell raw steel from a Japanese raw steel producer to a Japanese steel fabricator at below cost. The products are fabricated and shipped into this country. They are sold in this country; they undersell in this market fabricated American steel products. We don't have a law on the books that reaches downstream dumping.

No one denies that is the case. I haven't seen the Japanese deny it.

I sat with Ambassador Brock. The chairman was there. He told us they are dumping. They are selling at below cost. I am saying that we have to deal with these real problems. It does happen.

Ms. Brown. I am sure there are cases of protectionism. I was not in any way, when I was talking to Congressman Schulze, trying to imply that Japan is saintly and has no nontariff barriers. Of course, there are nontariff barriers here and over there. We keep restating that.

I think that what we differ on very seriously is how to solve the problem for the benefit of the United States. That is the problem of trade policy in a nonperfect world.

I think that really is what you are aiming at.

Mr. Bailey. Anyway, I think there are——

Mr. Schulze. If I could reclaim my time, I would like to clarify my own thinking on your response to my question.

My question basically was, don't you think that Japan has been a textbook example of a protectionist policy which has worked? I presume your response is that you have not been convinced that they have used protectionist policies; is that correct?

Mr. Trezise. Congressman, there was a time when Japan protected everything. Japan even protected its raw cotton industry. Japan doesn't grow an ounce of raw cotton, but it had a quota on imports of raw cotton. This went on for a long period after the war. A lot of industries were protected. They were protected not only against foreign competition; they were protected so much that they had to pay high prices for their raw materials because of this pervasive protection.

Since the latter sixties, the Japanese have reduced protection pretty well across the board. I think protective measures now, taking everything into account, are probably at the average of other industrial countries. That is where we are.

There is no point in taking 66 or 97 individual things and saying these amount to such and such. We do not know how much they amount to in point of fact.

Many of them are clearly not very important. Some of them are probably quite important. The administration, I think, is going to have some success there. That is fine. I don't wish the Japanese consumers any poorer time than any other consumers. The Government of Japan does not always give the consumer a fair shake. That is their problem, however.

What we are saying is, we don't believe that the American consumer should be penalized because the Japanese Government is sometimes unfair to its consumers. That is the long and short of our position.

Mr. SCHULZE. I think we have to look at the long-range health of our economy. I agree with you, but we also have to take all of these factors into consideration as we look long-range.

I thank you very much for your testimony.

Chairman GIBBONS. Any other questions or observations?

Thank you very much for coming this morning.

Our next witness is Mr. James Hacking, assistant legislative counsel for the Retired Teachers Association.

While we are waiting, let's talk about the Export-Import Bank.

I supported the Export-Import Bank. I am reevaluating my position as I do on all legislation, but until we can get a better agreement on export financing, I think the Export-Import Bank is one of those necessary evils that we have to have.

Mr. BAILEY. I agree with you, Mr. Chairman.

Chairman GIBBONS. We need some kind of GATT-type rules on export financing.

Just to give you a little vignette of what could happen, a number of years ago, in the AID program, we built the Moroccans a harbor so they could export their phosphate into the world market.

We also produce phosphate. In order to keep America competitive with the harbor we built for the Moroccans, we spent about $150 million keeping the principal American phosphate export harbor competitive.

Now, the Export-Import Bank is taking another leap—before it was AID, now it is the Export-Import Bank—they are lending at subsidized rates credit to allow the Moroccans to buy more modern equipment.

Where this all ends, nobody really knows, but it starts off with an AID project, then comes in with a domestic public works project on this side; then goes back to an Export-Import Bank loan.

You have high unemployment in all these areas. Government would be a lot better off if we just tried to set some reasonable ground rules and got out of all these crazy subsidy businesses that we are in.

To observe on the Japanese, I think anybody that has been to Japan probably knows that they have the most docile group of consumers in Japan. No American would put up with the kind of food prices, housing prices, everything they have to put up with in Japan.

I don't know how much longer the Japanese consumer is going to put up with being kicked around.

I am glad the folks that were just here were here because we live—we don't live to work; we work to live is my philosophy.

I think we have to constantly keep our eye on where does all of this end?

STATEMENT OF JAMES HACKING, ASSISTANT LEGISLATIVE COUNSEL, NATIONAL RETIRED TEACHERS ASSOCIATION AND AMERICAN ASSOCIATION OF RETIRED PERSONS, ACCOMPANIED BY ROBERT BRUNNER, LEGISLATIVE REPRESENTATIVE

Mr. HACKING. Thank you, Mr. Chairman.

I am Jim Hacking, assistant legislative counsel for the National Retired Teachers Association and the American Association of Retired Persons.

As I am sure you are aware, these organizations have a very large membership. It is now in excess of 13 million persons aged 55 and over.

The associations' view on foreign trade policy is basically quite simple.

We oppose actions which restrict the free flow of trade and services into and out of the United States.

We take this classic free trade position because we feel that actions which curtail free trade contribute to misallocation of resources, lower productivity and higher inflation rates and we are mandated by our membership to oppose any and all policies which could increase inflation.

Practically, this policy means opposing the attempts by industries and their workers to limit imports either through tariffs or quotas. There are far too many such restrictions already in force.

For example, imports of textiles are limited by the Multi-Fiber agreement, prices of imported steel are artificially raised by the trigger price mechanism, and last year the Japanese Government and auto industry were pressured to accept a voluntary—meaning involuntary—limitation on exports to the United States.

These are only some of the more conspicuous examples of measures limiting imports of lower-priced or more attractive foreign products—those that are characterized as unfair competition by domestic producers.

It is ironic that in a nation supposedly devoted to free market doctrines, that price competition, which admittedly is not the only type of competition, but is the most effective, should so often be characterized as unfair.

The group voicing such complaints should be reminded that fairness in pricing has nothing to do with competition, but harks back to a medieval precapitalist economy and society or, more recently, to the 1930's experiment with the NRA.

Protectionist actions have a double whammy. Not only do they raise the price level by excluding less expensive goods, but by subsidizing inefficient industries they result in maintaining too many resources in high cost and often declining industries, diverting them from more efficient growth industries.

Continued attempts to prop up what may turn out to be sunset industries can only help to reduce the growth of new industries and productivity that is essential for increases in living standards.

The decline and cessation of productivity growth in the seventies and the actual decline in productivity in the last 3 years, have undoubtedly had several causes, and it would be difficult to argue that import restrictions have been a major factor, but they have certainly not helped.

Furthermore, in the case of the steel and automobile industries, import restrictions do not seem to have helped the U.S. industry very much, demonstrating that their problems go far beyond import competition.

Both industries continue to decline. In the case of automobiles, it appears that the Japanese auto industry has reacted to the voluntary limitations by exporting more expensive models, and more aggressively searching for markets in the underdeveloped countries where there may be more potential for growth than in the United States, which already has a high automobile to people ratio.

Our opposition to import restrictions does not mean that we would let all industries suffering from import competition decline without limit.

For example, the United States needs to preserve some level of domestic steel-producing capacity, which may be determined to be, for security reasons, higher than its consumers are ready to pay for.

This is a valid policy consideration, but it should be implemented by a direct subsidy to the industry from the Federal Government, not by forcing domestic consumers to subsidize it.

The point is that a case can be made for subsidies, but they should be visible and financed in the broadest possible way.

Perhaps Congress could explore some type of reconstruction refinance corporation.

Nor are we indifferent to the plight of the workers displaced from declining industries and stranded in communities without alternative employment opportunities.

Youngstown and Detroit and the unemployed who live there, have genuinely serious problems.

However, restrictions on imports of steel and autos are not the way to solve them. What is needed are policies which help these communities and workers adjust to the new situation.

The workers need extended unemployment compensation, retraining, and relocation assistance. We are not as confident that we can prescribe as precisely for their communities, but some form of readjustment assistance is obviously necessary.

In conclusion, Mr. Chairman, we wish to remind the subcommittee that inflation is and remains the chief concern of and chief threat to the elderly. We do not wish to see Congress resort to protectionist legislation that is likely to aggravate the country's inflation problem and make it even more intractable than it already is.

Thank you very much.

[The prepared statement follows:]

STATEMENT OF THE NATIONAL RETIRED TEACHERS ASSOCIATION AND THE AMERICAN ASSOCIATION OF RETIRED PERSONS

The National Retired Teachers Association and the American Association of Retired Persons, together representing some 13 million members, are pleased to have the opportunity to present our views on foreign trade policy to this subcommittee. That view is basically very simple: we oppose actions which restrict the free flow of trade and services into and out of the United States. This can be labeled the classic free trade position. We oppose actions which curtail free trade because they contribute to misallocation of resources, lower productivity, and higher inflation rates, and we are mandated by our membership to oppose any and all policies which could increase inflation.

Practically, this policy means opposing attempts by industries and their workers feeling the pressure of import competition to limit imports, either by tariffs, or more commonly, by quotas limiting the volume of imports. There are far too many of such restrictions in force. For example, imports of textiles are limited by the Multi-Fiber agreement, prices of imported steel are artificially raised by the "trigger-price" mechanism, and last year the Japanese Government and auto industry were pressured to accept a "voluntary" (meaning involuntary) limitation on exports to the U.S. These are only some of the more conspicuous examples of measures limiting imports of lower-priced or more attractive imports—those that are characterized as "unfair" competition by domestic producers.

It is ironic that in a nation supposedly devoted to free market doctrines, that price competition, which admittedly is not the only type of competition, but is the most effective, should so often be characterized as "unfair". The group voicing such complaints should be reminded that "fairness" in pricing has nothing to do with competition, but harks back to a medieval pre-capitalist economy and society.

Protectionist actions have a double whammy. Not only do they raise the price level, by excluding less expensive goods, but by subsidizing inefficient industries, they result in maintaining too many resources in high cost and often declining industries, diverting them from more efficient growth industries. Continued attempts to prop up what may turn out to be "sunset" industries can only help to reduce the growth of new industries and productivity that is essential for increases in living standards. The decline and cessation of productivity growth in the 1970's and the actual decline in productivity in the last three years, have undoubtedly had several causes, and it would be difficult to argue that import restrictions have been a major factor, but they have certainly not helped.

Furthermore, in the case of the steel and automobile industries, import restrictions do not seem to have helped the U.S. industry very much, demonstrating that their problems go far beyond import competition. Both industries continue to decline. In the case of automobiles, it appears that the Japanese auto industry has reacted to the "voluntary" limitations by exporting more expensive models, and more aggressively searching for markets in the underdeveloped countries where there may be more potential for growth than in the U.S., which already has a high automobile-to-people ratio.

Our opposition to import restrictions does not mean that we would let all industries suffering from import competition decline without limit. For example, the U.S. needs to preserve some level of domestic steel-producing capacity, which may be determined to be, for security reasons, higher than its consumers are ready to pay for. This is a valid policy consideration, but it should be implemented by a direct subsidy to the industry from the Federal government, not by forcing domestic consumers to subsidize it. The point is that a case can be made for subsidies, but they should be visible and financed in the broadest possible way.

Nor are we indifferent to the plight of the workers displaced from declining industries and stranded in communities without alternative employment opportunities. Youngstown and Detroit, and the unemployed who live there, have genuinely serious problems. However, restrictions on imports of steel and autos are not the way to solve them. What is needed are policies which help these communities and workers adjust to the new situation. The workers need extended unemployment compensation, retraining, and relocation assistance. We are not as confident that we can prescribe as precisely for their communities, but some form of readjustment assistance is obviously necessary.

Chairman GIBBONS. Thank you, Mr. Hacking. I appreciate your statement. I think it is a good, sound statement.

Mr. Bailey?

Mr. BAILEY. Thank you, Mr. Chairman.

Why are these industries declining?

Mr. HACKING. Let me ask our staff economist, Mr. Brunner, to comment on that. I am not sure that anybody has the conclusive answer to that question.

Mr. BAILEY. I do.

Mr. BRUNNER. I don't think it resides solely in foreign trade. I think there are other factors which are affecting them.

Mr. BAILEY. Agreed.

Mr. **Brunner**. These factors include the overage facilities of the steel industry and the fact that the automobile industry ran head-on into an increase in fuel costs which would have hurt it without there being competition from imports. In the case of both industries, their above-average compensation rates have certainly not helped because these have tended to price their products at least to some degree out of domestic markets. The point here is that there are a variety of factors.

Mr. **Bailey**. I just didn't want anybody to think that a prestigious organization that—and I know many of the members that you have back in my district, retired steelworkers, retired autoworkers, et cetera, I just would not want anybody to think that your definition of declining industry was some reflection on some thought that these industries were dying out worldwide, let's say, or demand for steel, you know, which is very cyclical, or automobiles, for example, that the industries were dying.

I just wanted—I am sure that is not your position. I am sure that would not be your position.

What is your membership? Do you have any representation overseas? Are you international in any way at all?

Are you affiliated with any international groups?

Mr. **Hacking**. Not really, other than in the most minor sense.

The National Retired Teachers Association is the parent organization. We have about 600,000 retired teachers. AARP is far larger, about 12.5 million. The members are people 55 years of age and over. Some of the members live abroad, for example in Mexico, or across the Canadian border. We are affiliated with an international aging organization, but only by affiliation. They are not direct members.

Mr. **Bailey**. I don't want you to get the wrong impression. I am not implying that as some reflection on you. I think in terms of the input to you and your view on things, I must say this to you. I have to say this to you honestly. Please don't be offended.

I think it is a little simplistic. I wish it was your way. I will just end with this.

Something the chairman just said here, maybe one of the best things said before this committee. That was, he was talking about Japanese consumers. The pressures they feel and the pressures that they are under and the things that they are deprived of because of certain policies that do redirect resources in that country.

I would very gently suggest to you folks that before you throw out terms like declining industries and—indicating that the future—you know, I even had somebody, one of the Congressmen, say what the heck should we worry about a steel industry for, this economy is moving towards a service economy.

Well, I don't know if you can ride that future safely, purely as a service economy.

I think what you have to do is, you have to make the ground rules fair and then you have a right to criticize if they have been.

I would hope that you could balance some of those remarks that you make sometime in the future with just a few additional things.

I do invite your comments.

Mr. **Hacking**. A comment on your points, Congressman. Perhaps you prefer the word "troubled" industries to "declining."

Whatever word you choose to apply, there are obviously some economic sectors in this country having serious problems.

Our point is that throwing up protectionist trade barriers is not going to solve those problems.

Mr. **Bailey**. Well, let me say this to you: If you don't have any other recourse, I really don't know what you do. If you look at it, there is a pattern in America. It is a pattern that does not make a whole lot of sense.

You find that capital intensive industries in this country for some reason share some unique problems. Maybe it is because of our tax code. Some people feel it is because of labor settlements.

I think it is a combination of things.

I think we have to learn to deal with that in a fair kind of way, but I know this much: We are signatories to an international agreement that makes certain comments about subsidization.

You are up against planning in other countries that targets certain things, targets industries, for example.

I don't know how we are going to compete with that if we don't take some steps. I am not—I tell you what, I am not one Congressman that is going to throw up my hands and give away the store because groups like yours come in and say it is in the best interests of the consumer to simply view world trade as a matter of tariff barriers.

It is not that simple. There are tax environments in other countries that are different than in ours. There are trade restrictions and import restrictions and marketing restrictions that are different from ours, and I am not saying we are perfect. You understand me?

I am not saying we are perfect. Please don't think that we are totally innocent. We made a lot of mistakes, but I really think when you say those things, I think we have to make sure that we don't create the impression—and you shouldn't create the impression among your members. I hope by editorial policy you are more expansive when you write to your membership.

I think we have to be more balanced about what some of the reasons for these things are.

The reasons aren't always as simple as we are hurting the consumer because we are putting up trade barriers. It is not that simple, just not. I wish it were. It would be easy for us.

We could take down our trade barriers.

I have complete faith in the American worker, in American business, in the American Government and the American people to work out their problems and go out and compete.

The world is not that way.

Mr. **Hacking**. Congressman Bailey, again I would reiterate the point I made in the conclusion of my statement. Our reason for being here is because inflation is high and sustained and hurting not just older people and the programs that serve them, but also the domestic economy.

Mr. **Bailey**. Let me say this to you: Inflation is best combated—and it is common knowledge, I suppose—by productivity increases. Nobody argues with that. As far as productivity increases are concerned, they take capital, investment policies, all kinds of resources and decisions that a society can muster. All right?

And I will be darned if I am willing to sit down and say that the American consumer who you are speaking for today is supposed to foot the bill completely and unfairly for the redevelopment of the world. We do have a standard of living. We do have people's rights and the chairman made this comment when he was talking about the—excuse me—and the chairman made this comment when he referred to the Japanese consumer.

I am not saying we are supposed to fight their battles, but I am not going to sit down and finance at the expense of American consumers and my senior citizens targeting industries and long-range governmental planning and some desire to become a technology exporter in 10 years by Japan when it is done in a way that includes taking ours in some cases unfairly or depriving Japanese consumers of things that maybe they should be entitled to—I don't know—but at least at the expense of America.

We have to start playing by the same ball game internationally. That is where the world has got to go. I am not saying the United States is not subject to criticism because of those things, but you just can't keep telling the American people these little arithmetic interpolations of what trade is all about when the whole picture is a little more complicated and more indirect than these tangential things that don't seem to mean anything, do mean something about what is going to happen to this country 15, 20, 30 years down the road when we have to support this aging population.

We better have an industrial base in place fairly arrived at. I don't want to take anything from the Japanese or the Europeans. I think we need to help the Third World somewhat, but I am sick and tired of us just in the name of free trade letting everybody play by our rules here when we can't play by the same rules abroad or internationally. It is not fair.

Mr. **Hacking**. We certainly agree with you that productivity gains are very important. We need a healthy, growing and vibrant economy if we are going to provide the kind of economic pie necessary to serve this large and growing elderly population and everybody else too.

What we have suggested in our statement is that we look at some ways—perhaps a reconstruction finance corporation type of arrangement—to channel investment capital into some of the major basic industries like steel and autos that we need to have even if it is just for national security reasons. But we should do it directly rather than indirectly through consumer subsidies.

Mr. **Bailey**. I am awful glad to hear that. I am glad we got there. I don't know if I like that mechanism. I would rather do things with the tax code. I am awful glad to hear what you just said. There are other considerations.

Mr. **Hacking**. We think our statement has a lot of balance to it, Congressman. We think there are good thoughts in there that ought to be explored.

Mr. **Bailey**. You make me feel better. I want to apologize to you if I may have challenged your statement here, but what you just said makes me feel better. I thank you for that.

Chairman **Gibbons**. I would remind my colleague, we are not going to be able to do anything else within the tax code. Capital-intensive industry in the United States will not be paying any taxes. Under the 10-5-3 with investment credit, in effect they will be receiving a subsidy already through the tax code.

There isn't anything else you can do unless you go put them on the payroll up here.

Mr. BAILEY. With the exception of the last statement, I agree with the chairman at least somewhat.

Chairman GIBBONS. There is nothing left.

Mr. BAILEY. I agree with the chairman somewhat. I will give you an example. Subsidization may be the issue. I am glad you brought it up. If you went to Canada and talked about our tax code now and wanted to build a steel mill there, you may want to call it subsidization. The net effect of tax rate combined with credits and deduction schedules in Canada, for example, may have that effect. I admit we may have to describe that situation as—a subsidization; but the point is, Mr. Chairman, given the marketing of those products in the United States, it amounts to an unfair disadvantage for our companies.

I don't want to do those things, either. I think you are right. I am just saying other folks do it differently. Until we learn to deal with that effectively, we are not going to be able to say they are on an equal footing, because they are not, Mr. Chairman.

Chairman GIBBONS. Well, I am not exactly sure what the Canadians do. I have a little trouble understanding their system.

Mr. BAILEY. They write off in 28 months, Mr. Chairman. A comparable piece of American equipment that would be written off at least under our old law in 5 years, they would write off in 28 months.

Chairman GIBBONS. When you have the interaction of the investment tax credit and 10-5-3, nobody has a more generous system of capital accumulation than we do unless they are just outright subsidizing.

In fact, we are outright subsidizing under 10-5-3 and the investment credit capital-intensive industries in the United States. That was the battle last year between my tax proposal that most of the members on the Ways and Means—Democratic members supported, and 10-5-3.

Mine, even with instant writeoff, expensing of capital investment was not as generous as 10-5-3 with the investment credit.

So, we have gone as far in the tax code as you can unless we are going to ask the consumer to subsidize your steel industry outright. Not just by protection, but by actual gift. If we do, we ought to put it in the budget and say to Don Bailey's steel industry so many billions.

You know, we slide it through the tax code now.

That is why United States Steel is out buying Marathon.

Mr. BAILEY. I don't see why they want to if the deal is that good.

Chairman GIBBONS. They have so many tax writeoffs now they have to pick up somebody that has more income. They can't use it all.

Mr. BAILEY. Mr. Chairman, on certain parts—certain parts of equipment there is probably an effective subsidization rate of about maybe 6 or 7 percent under the combination of depreciation schedules and tax credit. I agree with that. However, one statement you made that I expect to fully disagree with is that other countries around the world are not as generous.

I really do not think when you look at the incidents of some of their loan and subsidy programs—I could look at Sweden as a perfectly good example and Japan as a second one—and their tax codes and approaches that they are less generous than us.

Chairman **Gibbons**. Maybe they are just stupider than we are.

Mr. **Bailey**. Mr. Chairman, we will be pay for those products after we can't make them any more.

Chairman **Gibbons**. Oh——

Mr. **Bailey**. Well, Sony televisions are expensive, Mr. Chairman.

Chairman **Gibbons**. OK. Anybody else with any observations? Mr. Schulze?

Mr. **Schulze**. Thank you, Mr. Chairman.

Chairman **Gibbons**. Thank you very much for coming.

Mr. **Hacking**. Thank you.

Chairman **Gibbons**. I appreciate your testimony, even though Mr. Bailey doesn't.

Mr. **Bailey**. I appreciate it. We got there.

Chairman **Gibbons**. OK.

Mr. Richard Wilcke, president of the Council for a Competitive Economy, accompanied by Mr. Sheldon Richman, director of the research council.

STATEMENT OF RICHARD W. WILCKE, PRESIDENT, COUNCIL FOR A COMPETITIVE ECONOMY, ACCOMPANIED BY SHELDON L. RICHMAN, DIRECTOR OF RESEARCH

Mr. **Wilcke**. Thank you, Mr. Chairman.

Chairman **Gibbons**. We are glad to hear you.

Mr. **Wilcke**. We have submitted a statement for the record which I will not bother summarizing or even discussing. Let me make a few additional comments.

Chairman **Gibbons**. It will be put in the record at the end of your testimony.

Mr. **Wilcke**. I am Richard Wilcke, president of the Council for a Competitive Economy, a national membership association of businesses and business executives from all 50 States.

We have something over 1,000 members and they represent all kinds and sizes of industries. Our common goal is an economy operated and structured on the basis of market rather than political forces. To that end, we are as opposed to government action aimed at helping business—whether subsidies, loan guarantees, special privilege, or protection—as we are to those which clearly harm business.

On that score, Mr. Chairman, we are not only opposed to all kinds of import restrictions, we are also opposed to the subsidization of manufacturing, promoting, or financing of exports.

In our view, policies on trade or any other kind of economic policies are proposed because they are assumed to be capable of achieving stated goals.

That assumption is based upon theory and experience. The policies often pursued and proposed by the United States in trade policy are often based upon outdated and discredited theories. I say that because the single most revealing characteristic of mercantilism was the belief that exports were better for an economy than imports.

We submit that current talk on trade is essentially mercantilist in its perspective in that we go to great lengths to encourage exports while we look on imports as a significant public policy problem.

We focus on bilateral statistics on trade and we use deficits as an indicator of the severity of these perceived problems. I can only say we are deeply grateful that there are no border guards and Customs agents keeping track of trade between our States, such as Maryland and Virginia.

One of those States—I have no idea which—has a trade deficit which would only be used as a rationale for negotiation, countervailing duties, or a demand for reciprocity.

Mr. Chairman, it is not just Adam Smith, but virtually the entire economics profession that has agreed that mercantilism is a stultifying, counterproductive system. Our view is that we should reject it out of hand and refuse to allow ourselves to be goaded into policies that rest upon mercantilist theories. Exports are no better than, nor worse than imports.

Trade must find its own level based upon a wide array of factors, some of which may be political. The fact that other countries may have a mercantilist perspective does not by any means justify such policies on the part of the United States.

Economic nationalism and tension-provoking trade wars will not serve the American people.

The second point is that the notion of reciprocity or fair trade is unethical, unworkable, and totally counterproductive from the standpoint of economic recovery. The worst possible step that we could take for the economy would be to lead the world into a new era of protectionism.

Reciprocity is a "beggar thy neighbor" approach to trade that would lead to the same contractions that U.S. policies led to in the 1930's. We mentioned Smoot-Hawley here. Let me recall that U.S. exports in 1929 totaled $5.5 billion, but by 1932, they had fallen to $1.7 billion. That was a direct result of the protectionist policies of the Hoover administration's Smoot-Hawley tariff. The tariff spawned a worldwide protectionist era and I think it was the worst possible solution or the worst possible response we could have made to the 1929 Crash.

It is not the only factor, obviously, but it was certainly one. Similarly, churlish demands for reciprocity today will also rule out any hopes of economic recovery. What other nations do is not justification for U.S. interference with trade. Their restrictions and their subsidies—as has been said here—are unfair to their own consumers and taxpayers, but they cannot be said to be unfair to U.S. competitors.

Mr. Chairman, let me make the point that competition between foreign and domestic manufacturers is not a business school exercise to determine which is the most efficient producer under equal conditions.

The sole purpose of economic production is to attract and serve consumers. Just as it is folly for an individual to make at home what he can buy, so it is folly for the United States to take actions to raise the price of products to our consumers.

We simply cannot make-up-for, or counter, what other countries do, regardless of how much we may like to. On that basis, we believe we should unilaterally drop restrictions on trade into the United States. Trade across national borders does not differ from trade within. Only politics makes it seem that way. Bilateral trade flow statistics are meaningless. America, and I mean by that the American people, would be better served if no one knew what the balance of trade was with any specific countries during any specified period of time.

Finally, Mr. Chairman, let me make one comment about national-security arguments since this supposedly noneconomic reason for trade interference is invariably resorted to when all economic arguments are shown to be without merit.

I might add that any plausibility of economic arguments for protection is inversely proportional to the size of the district or region. I can understand why a single Congressman, a single company, a single industry, or a single city like Detroit might like protection or believe in it. But there is no argument, from the infant-industry one to the national-security one, that is plausible when the sample is large, or covers the United States. No one who represents the interests of the entire United States should give even a moment's consideration in our view to restrictions or threats of retaliation.

Finally, regarding national security: I hear it argued, Mr. Chairman, that the United States should restrict the flow of certain goods into the United States in order to make this country stronger and better prepared in case of war.

At the same time, often from the same people, I hear that the United States should restrict the flow of certain goods into communist countries in order to make those countries weaker and less prepared in case of war.

Mr. Chairman, I submit to you that the same policy cannot have contradictory effects. That is restricting the flow of goods into a country will either make it weaker or stronger. It cannot do both. The truth is, as every economist from Adam Smith to Paul Samuelson has argued, restricting the flow of goods into a country can only reduce productivity, lower standards of living, and generally hamper the economy.

If our military policy is to prevent certain Communist countries from growing in strength through trade with the West, an embargo will have that effect. But there is simply no legitimate national-security argument for restricting the flow of goods into the United States—putting a limited embargo on ourselves—because even limited restrictions will tend to weaken, not strengthen, our economy.

Granted, many industries, from steel to automobiles to textiles to oil to high technology products are currently using a national-security argument for government manipulation of trade.

But if we want the United States to be strong, we should permit our economy to flourish. To do that, we should, as the world's largest, most important economy, open our borders.

I should mention, Mr. Chairman, that our members are not basically importers. Many of our members have been hard pressed to meet foreign competition. This doesn't change their belief in the benefits and justice of free trade.

We would urge this Congress and U.S. policymakers to reject economic nationalism that might lead the United States in a new era of protection. Instead, we urge free trade regardless of what other countries do, opening up a new era of prosperity and peace. I thank you.

[The prepared statement follows:]

STATEMENT OF RICHARD W. WILCKE, PRESIDENT, COUNCIL FOR A COMPETITIVE ECONOMY

Mr. Chairman and members of this Committee, thank you for the opportunity to present our perspective on this issue, namely U.S. policy regarding international trade. My name is Richard W. Wilcke, president of the Council for a Competitive Economy, a national membership organization of businesses and individuals from from all 50 states. Our membership includes businesses of all sizes and from practically every industry. Our common bond is a principled belief in the justice and efficiency of a free and competitive market economy. While we certainly oppose, with other business groups, the burdens of taxes and regulations on U.S. business firms, we also stand with consumer groups, or alone on many occasions, in opposition to subsidies, protection or special privileges meant as "pro-business" interventions.

We have noted with interest the recent increased attention paid to U.S. trade policy. While a number of our members are hard-pressed to meet foreign competition, they are nonetheless convinced trade interferences are not in the long-term best interests of this nation. This is true from the perspective of taxpayers and workers, both groups best served by economic recovery. And it is true from the perspective of American business people, whether importers, exporters or solely domestic. Our position, therefore, is that the U.S., with the world's largest economy, should not lead the world into a new era of protectionism, but into a new era of prosperity marked by free trade. We call for the unilateral lowering of U.S. trade barriers of all kinds. In our view, nothing would better serve Americans, and America.

Those who advocate active government involvement in world trade have plenty of justifications, all of which sound superficially plausible. However, we believe they are all without merit. These age-old rationalizations include: (1) the idea that unemployment in the U.S. is caused by lower-priced labor in other countries; (2) the idea that subsidization of certain industries in other countries justifies intervention by the U.S. government for "fairness;" (3) the popular national-security arguments for selected protection in case of armed conflict; and (4) the idea that the government should manipulate trade in order to achieve an import-export balance. In our view, none of them justify this government's interference with the flow of goods in or out.

Adam Smith earned the title, "father of modern economics," by his devastating refutation of mercantilism, Wealth of Nations published in 1776. Smith argued that the wealth of a nation lies not in its supply of gold, but in its people, its division of labor, and its voluntary exchange. He observed that communities prospered when the best shoemaker devoted all his energies to making shoes, thereby increasing his skills through specialization, and then traded through barter or money for other things that he and his family needed. Wrote Smith, "It is the maxim of every prudent master of a family never to attempt to make at home what it will cost him more to make than to buy." Smith then went on to argue for over 1,000 pages that the existence of national borders did not change the process of free trade. This same principle, Smith pointed out, explained the real "wealth of nations." Saving jobs or adding labor is never a good reason for restricting the flow of goods across borders.

Mercantilists prior to Smith believed that exports were inherently superior to imports. They argued that trade policy should always encourage exports, while imports were something to be tolerated at best. I submit that most current discussions of trade policy are taking a mercantilist perspective. Spokesmen for this Administration, for business, and even some members of Congress, talk in the very same terms. They urge the encouragement, even subsidization, of exports while they discuss imports as a public-policy "problem." Imports are, to read these views, an unwanted assault on America. Adam Smith destroyed this notion; these neomercantilists should not be permitted to revive it.

Mr. Chairman, lest we be accused of citing only an 18th century economist, and one with decidely pro-market views at that, let me add the words of a 20th Century

Nobel Laureate, Paul Samuelson of MIT: There is essentially only one argument for free or freer trade, but it is an exceedingly powerful one: namely, unhampered trade promotes a mutually profitable international division of labor, greatly enhances the potential real national product of all countries, and makes possible higher standards of living all over the globe.

Professor Samuelson is no worshiper of the market. However, he is a well-known and respected economist. And while we would be the first to argue that consensus of experts doesn't guarantee truth, I point out nonetheless that we could quote many, many economists on free trade. The economics profession is united on this issue.

With indulgence, Mr. Chairman, let me use a simple illustration. Everyone who ever studied economics is familiar with Robinson Crusoe, the famous shipwrecked sailor who, in Daniel Defoe's novel, lived alone on an island, or with only a servant. In the book, it took Crusoe fifteen full days to cut down a tree and trim the log into a large needed plank. During these two weeks, he had no time to fish, or gather food so he was forced to live on his stored provisions. He also dulled his hatchet in the process, which later took time to re-sharpen.

Suppose that on the first morning he was to begin his work, a plank exactly like the one he proposed to make, washed up onto the shore. Free traders (followers of Adam Smith) would suggest that Crusoe retrieve the plank and save himself a lot of time and trouble. Not so . . . as it turns out, Crusoe was of the 1982-tyle neo-mercantilist school of economics. He reasoned with himself that the productivity of his island economy depended on keeping his labor force fully employed.

"If I pick up this plank," he thought, "I would lose, not only 15 days of productive labor, but also useful work spent re-sharpening my hachet and replenishing my store of provisions." As a result of this "modern" economic analysis, Crusoe threw the plank back into the ocean lest it ruin his island economy.

This would be a funny story except for the fact that many Americans seem to be convinced that other nations are harming our U.S. economy and causing unemployment by providing goods at a lower price than we can produce them. They apparently believe that our economy could be completely destroyed if other countries sent us all their goods for free. Of course, the hypothetical response of Robinson Crusoe makes no sense, but neither does the idea that lower-priced (or free) goods harm the U.S. economy.

Just as flawed is the idea that unemployment is the result of imports or of competition with lower-priced labor. There is no legitimate argument that unemployment in Massachusetts can be blamed on lower wages in Oklahoma. Adjustments are essential to the functioning of our economy, whether within the U.S. or in relation to the world. The government simply cannot improve things by making it unnecessary for one industry or one region to adjust to real-world conditions . . . regardless of whether those conditions are political or non-political in origin.

From an economic standpoint, it is ridiculous to argue that U.S. policy should restrict the flow of goods into the U.S. in order to make it stronger and better prepared in case of war. Especially since the same people will turn around and argue that U.S. policy should restrict the flow of goods into Communist countries in order to make those nations weaker and less prepared in the event of war. The same policy cannot achieve contradictory ends. The fact is, restricting the flow of goods into a country will have one effect, not both. Again citing Dr. Samuelson, even limited restrictions can only make a country weaker. We should not do to ourselves in time of peace what enemies would do to us in time of war, that is, inflict an embargo on the U.S.

Trade between nations has been a significant contributor to progress, prosperity and peace. There are no worthy arguments, ethical or economic, that will stand the test of being good for all Americans. The larger the sample, the less plausible are the protectionist ideas. We urge a U.S. trade policy that will lead only to free trade with no exceptions.

Thank you.

Chairman GIBBONS. Thank you for reminding us of history and the lessons we have learned from history. You know, we used to have Mr. Hawley hanging over there on the wall. I am kind of sorry they took him out. I don't know where he is hanging now. He left here 4 or 5 years ago, but he always used to remind us that he was a very well-intended gentleman, obviously had his country's best interests at heart.

He became chairman of this committee, which is a very challenging responsibility and a very sobering experience for everyone who has ever been chairman of this committee.

So, I don't think he was a villain in the sense, but obviously his misdirected understanding of what the situation was then and a reading of history prior to that time was wrong.

Mr. Hawley and Senator Smoot, who was a Senator from Oregon, I think—something like that, as I recall—maybe I have the two mixed up—same kind of person. Just made a terrible mistake.

Don Bailey was too young. I had to fight a war because of the mistakes they made. It wasn't the only cause of that war, but it was a major cause of that war. I hope that you and your council will continue to spread the word around to remind us of the history that we have had and lived and mislived out of all of that.

I appreciate your coming here to talk to us about this.

Mr. Wilcke. Thank you, Mr. Chairman.

Chairman Gibbons. Don?

Mr. Bailey. Thank you, Mr. Chairman.

I, too, fought a war; spent a lot more time in contact, incidentally, than most of the American veterans of other wars. It is just a different point of view here at home about that one, I guess.

Mr. Wilcke, you know I think maybe we want to get to the same place. I was watching you read your statement with all that intensity. I respect that. I have a fair portion of it myself. I don't think it is that you have many people in this country—very few—at least in this Congress, who are bona fide protectionists.

They may get tagged that way, or you may classify or others may classify their policy recommendations that way, but I think what they are talking about is—I think they are as dedicated to free enterprise and to some of your—your and my and Adam Smith's goals on productivity and efficiency, et cetera, et cetera, et cetera, et cetera, equals free enterprise, et cetera, et cetera, et cetera.

I think that when people grope for solutions to problems, it is because they believe in a country and they believe in principles that are greater than that country. They come first. That is what makes us greater—we like to think—I think it is what makes us great as a country, the principle underlying what we want to do.

Plainly and simply, we are not going to get there if we have got barriers that we have to fight against. There is some way you have to fight against them. I don't know how. Nobody here wants to raise them. Nobody here wants to erect unreasonable barriers. I don't want to do that. I don't think anyone else who makes recommendations of a retaliatory nature, et cetera, wants to do that.

I think we have to start developing—I say this time and again. It never sinks in. It will eventually, I am willing to bet. We have to erect some kind of international rules, because it is a two-way street. That goes for both sides. Incidentally, I do not represent very much at all basic steel. I want you to know that as a backdrop to what I am going to say. I really don't.

I represent, in fact, a very export-conscious industry until we squelched it, probably more of the nuclear industry than any others, incidentally; but on high technology military items, I did serve a term on the Armed Services Committee: Where I got my ideas about this Nation's industrial base was from some subcommittee work I did there.

It does concern me a great deal. I may have misunderstood you. I don't think you were saying that on high technology items, that there may not be sufficient military value that you would argue against transferring those items or trading on them.

For example, high technology computers. You don't recommend a dropping of restrictions on high technology items, do you?

Mr. **Wilcke**. Are you talking about East-West trade?

Mr. **Bailey**. Communist——

Mr. **Wilcke**. Our selling to the Soviet Union, for example?

Mr. **Bailey**. Yes.

Mr. **Wilcke**. We were not arguing what the strategic military position should be for our country. We are saying that if our goal is to prevent the Soviet Union from getting strong, an embargo will have that effect. We are saying it does not work in the other direction, though. That is our view.

Mr. **Bailey**. In other words, the import restrictions should be dropped? That is the important thing. You are not saying to me, Geez, drop the restrictions against the export of certain high technology items to the Soviet Union?

Mr. **Wilcke**. I would say, if that is the military policy goal, then we have agreed that that economic policy would have that effect. Military policy is not our concern. We are talking about the economics of this country.

So, I agree. If it is the goal of military policy to make the Soviet Union weaker, yes, restrictions will have that effect. We are not here to argue against that. We are here to argue against national security arguments for protection or for the restriction of imports into the United States.

Regarding the steel industry, I don't think it is correct that we need a 150-million-ton steel industry in this country in order to be sound.

Mr. **Bailey**. You wouldn't argue if all things were equal and we were a competitive steel exporter, you wouldn't argue with that if that were the case? You would say that makes good comparative advantage sense if that were the state of the world's economy, all things being equal?

Mr. **Wilcke**. If we were exporters of steel?

Mr. **Bailey**. I am saying all things being equal, people can argue that our steel industry wouldn't be in the bad shape that it is. I realize that is hyperbole. I understand that. I think many of our internal policies are caused by that problem.

See, I think, in other words, it is sort of arm-chairish to me to talk about we don't need a 150-million-ton steel industry without talking about what our demands in steel tonnage are in this country.

The issue really should be whether or not an American producer can produce in as competitive an environment as some foreign countries. We know that steel industries are subsidized all over the world.

Mr. **Wilcke**. Let me just say the steel industry is like many other industries in that it is not precisely the "all-for-one-and-one-for-all" situation that the industry lobbyists would have you believe.

There is a tremendous range of success to failure. There are a number of steel companies competing very well with the Japanese. The ones having the most trouble are those with older, less modernized plants. There is no getting around that. But there is a tremendous range there.

Mr. **Bailey**. The lobbyists don't just—I studied a little bit on my own. I am just saying some of the reasons for that are the—we should look at some of those things, some of the reasons for it.

I appreciate your views here. I just think we have to look at the reasons why we have to come up with some policy alternatives, like it or not. I think we have to do that.

Mr. **Wilcke**. I couldn't agree more.

Mr. **Bailey**. Thank you, Mr. Chairman.

Chairman **Gibbons**. Thank you.

This concludes our hearings for today. The committee will announce hearing dates to complete testimony from other witnesses who have requested to appear as soon as the committee can get the time released to us.

The committee stands adjourned.

[Whereupon, at 12:05 p.m., the subcommittee adjourned subject to the call of the Chair.]

U.S. TRADE POLICY

THURSDAY, MARCH 18, 1982

House of Representatives,
Committee on Ways and Means,
Subcommittee on Trade,
Washington, D.C.

The subcommittee met at 2:05 p.m., pursuant to notice, in room 1100 of the Longworth House Office Building, Hon. Sam M. Gibbons (chairman of the subcommittee) presiding.

[Press release announcing the hearing follows:]

[Press release of Thursday, Mar. 4, 1982]

Hon. Sam M. Gibbons, (D-Fla.), Chairman, Subcommittee on Trade, Committee on Ways and Means, U.S. House of Representatives, Announces Completion of Private Sector Phase of Oversight Hearings on U.S. Trade Policy, March 18, 1982

The Honorable Sam M. Gibbons, (D-Fla.), Chairman of the Subcommittee on Trade of the Committee on Ways and Means, U.S. House of Representatives, today announces that the private sector phase of oversight hearings on U.S. trade policy begun in December (previously announced in press release No. 10, No. 11, No. 12, No. 13, No. 15, and No. 17) will be completed on Thursday, March 18, 1982. The hearing will be held in the Committee on Ways and Means main hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.

The schedule of witnesses will be available on Monday, March 15.

Chairman **Gibbons**. Good afternoon, ladies and gentlemen. This is a meeting of the Subcommittee on Trade of the Ways and Means Committee. Today we will complete the private sector portion of our hearings on U.S. trade policy: what it is now, how it is made, how our trade laws are operating and being administered and the agenda of trade issues for the 1980's. The hearing record for filing of written statements will remain open until March 25, 1982.

Our first witness today is Mr. O. M. Roetman. He is vice president of international sales of Boeing Commercial Aircraft Co. Mr. Roetman, we appreciate your attendance at our hearing.

STATEMENT OF O. M. ROETMAN, VICE PRESIDENT, INTERNATIONAL SALES, BOEING COMMERCIAL AIRCRAFT CO.

Mr. **Roetman**. Glad to be here, sir.

Chairman **Gibbons**. Glad to have you.

Mr. **Roetman**. We have made a formal submission of a paper separately, so in the interest of time today I would simply like to summarize the points that we made in the prepared statement.

Boeing, of course, wants to encourage this committee and the Government in general to keep our markets open for fair competition. With all the clamor in the press and here on Capitol Hill about foreign competition, we had some concern that you might lose heart and wonder if anybody out there really cares about keeping the markets open both here and abroad.

Well, we at Boeing care, and so do the thousands of our suppliers and subcontractors across the country. We call these subcontractors the invisible exporters. But it is these invisible exporters that have helped us become the Nation's leading industrial exporter for the past several years.

Our jetliners, of course, carry the Boeing name, but they are in fact a product of a nationwide industrial, technological, scientific, engineering and managing process that I think is probably unparalleled in the history of private enterprise. We have—I think, Mr. Chairman, you may have seen it—we have put together a brochure on who these invisible exporters are around the Nation. The number runs to some 2,000-plus, I believe, in that listing.

Foreign markets are absolutely indispensable for Boeing and the benefits are spread throughout the industry—that is, jobs—and that is probably the primary consideration. But it also means increased earnings to help us invest in the latest equipment to maintain our technological lead. I think it is ditto for our suppliers, particularly of avionics who, like Boeing, are important elements in the country's defense and industrial base.

The Nation's merchandise trade balance would look a lot sicker than it does without the consistent and increasing net surplus provided by commercial aircraft and spare parts. We see some risk to Boeing's export position in the years ahead. One is the nature of the competition we face from the European Government-owned consortium Airbus Industry.

Our prepared statement goes into that, to some extent. We are quite ready to compete openly and fairly with Airbus. They make a good product; so do we. But we cannot compete if we can only offer commercial bank credits at market rate while Airbus offers European government subsidized export credits at much lower rates. The solution we prefer is that all Governments get out of the business of subsidizing commercial aircraft exports.

It is wasteful and it is self-defeating, but it is worse than that if only the U.S. opts out. That is economic suicide, at least for our industry. So I must stress how vital it is that we have an adequately funded, aggressive Eximbank ready, willing, and able to match credit terms offered by our competitors.

Boeing exports may also be damaged by what appears to be a deteriorating international trade policy environment. These are tough times for a lot of companies, including ours. But we hope that we can keep the Nation from veering off in some entirely new direction in trade policy. Some of the rhetoric we have heard about the new buzz word "reciprocity" seems to suggest a bilateral balancing product by product or sector by sector.

If it does mean this and if other countries apply that policy, too, we would not see many commercial airplanes along with a lot of other things being exported. It is a prescription for economic decline and a downward spiral of retaliation and recrimination. I hope U.S. export interests will not be overlooked when you consider proposals for new trade legislation.

We have no sympathy for foreign trade practices that contravene international agreements. Such practices should be condemned and effectively countered. Where the rules are defective or nonexistent, we favor negotiations rather than unilateral attempts by the United States to legislate what is fair or unfair—because of course others can play that game, and we are concerned that successful American exporters may be the ones who end up paying the cost if we start to close U.S. exports.

Thank you. That is the end of my statement.

[The prepared statement follows:]

STATEMENT OF O. M. ROETMAN, VICE PRESIDENT OF INTERNATIONAL SALES, BOEING COMMERCIAL AIRPLANE CO.

Submission By The Boeing Company

to the

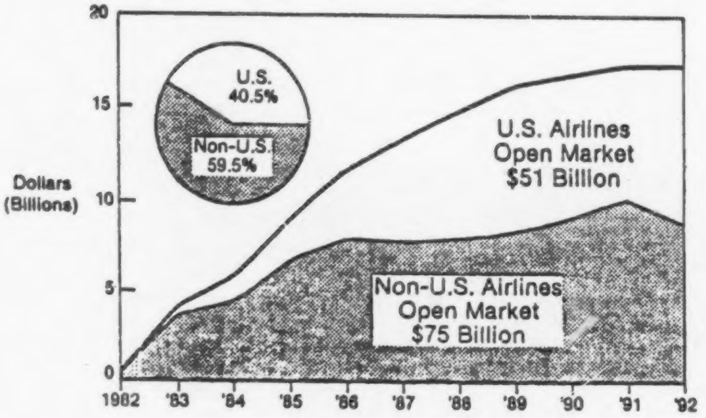
House Subcommittee on Trade, Committee on Ways and Means

U.S. House of Representatives, March 18, 1982

The Boeing Company of Seattle, Washington appreciates this opportunity to contribute to the Trade Subcommittee's oversight hearings on U.S. trade policy. Export markets are vitally important to Boeing. This has been so since the start of our jet age twenty-three years ago. From 1959 through the end of last year, Boeing has delivered a cumulative total of 4,090 commercial jetliners. Forty-four percent (1,806 aircraft) were for overseas customers. Our current forecasts indicate the overseas market for jetliners will be even greater in the years ahead – nearly 60 percent of the $126 billion open market over the coming decade will be non-U.S. carriers.

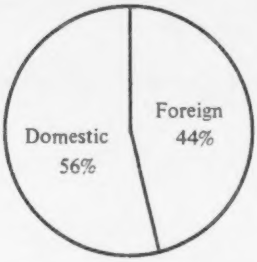
$126 Billion Open Market Through 1992

Deliveries (1982 Dollars)



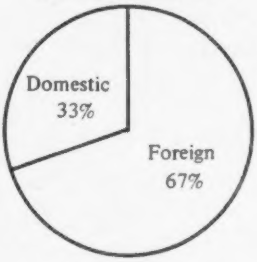
The importance of foreign markets to Boeing can be seen even more vividly by looking at the models that have supported the overwhelming bulk of Boeing's income and earnings while our new technology models have been under development. Sales of our 737 and 747 models have been our very lifeblood. Sixty-seven percent of all 737 and 70 percent of all 747 sales have been to overseas customers.

Total Boeing Jetliner Deliveries



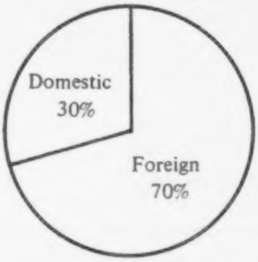
Total Deliveries	4,090
Foreign	1,806
Domestic	2,284

Model 737 Deliveries



Total Deliveries	823
Foreign	548
Domestic	275

Model 747 Deliveries



Total Deliveries	540
Foreign	376
Domestic	164

Cumulative data through 12/31/81

Exports of commercial jetliners have important positive effects on the domestic economy and the ability of the nation as a whole to achieve a number of major national objectives. We believe some of these effects and interrelationships are not as well understood as they should be.

Job creation is one of these effects. Based on a study by Chase Econometrics, the Aerospace Industries Association calculates that each $1 billion of jetliner export sales creates 91,200 job opportunities. (Boeing's jetliner exports alone in each of the past several years have been in the $5 billion range.)

EXPORTS OF COMMERCIAL JET TRANSPORTS

Create 91,200
Job Opportunities in

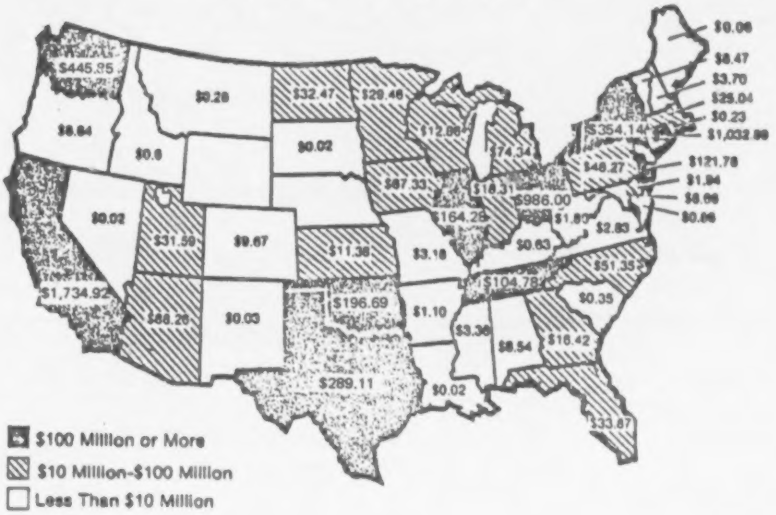
- Manufacturing
- Trade and Services
- Construction

For Each $1 Billion of Sales

Top Eight	
Aerospace	26,000 Jobs
Trade	20,000 Jobs
Construction	20,000 Jobs
Services	10,000 Jobs
Engineering and Scientific Instruments	4,000 Jobs
Communications Equipment	3,000 Jobs
Machine Shops	2,500 Jobs
Fabricated Metals	1,000 Jobs
Other	4,700 Jobs

These effects are widely dispersed through the country due to the fact that a modern jetliner involves thousands of subcontractors and suppliers.

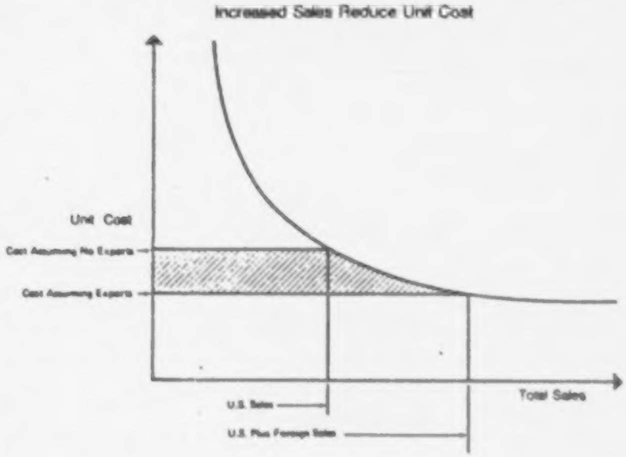
Commercial Aircraft Subcontractors Benefit Almost Every State


$0.06
$8.47
$3.70
$25.04
$0.23
$1,032.99
$121.78
$1.94
$8.06
$0.06
$445.85
$0.28
$32.47
$29.46
$8.84
$0.8
$0.02
$12.86
$74.34
$354.14
$48.27
$87.33
$18.31
$986.00
$164.28
$1.80
$2.83
$0.02
$31.59
$9.67
$11.38
$3.18
$0.63
$51.35
$1,734.92
$104.78
$0.35
$196.69
$88.26
$0.03
$1.10
$3.36
$8.54
$16.42
$289.11
$0.02
$33.87
▩ $100 Million or More
▧ $10 Million-$100 Million
☐ Less Than $10 Million

Earnings from overseas sales of jetliners play a vital role in helping us maintain our aeronautical technological lead. Without export markets on the scale we have experienced over the past decades, Boeing would be a much smaller aircraft manufacturer than we are today and we would not have generated enough earnings to permit the multi-billion dollar investment of our own funds required to bring state-of-the-art new models into production. Similar negative effects would almost certainly have rippled back to our suppliers, particularly the high technology avionics firms who also must invest substantial sums to remain leaders in the field. The potentially adverse effects of such a development on the U.S. defense industrial base also needs to be recognized.

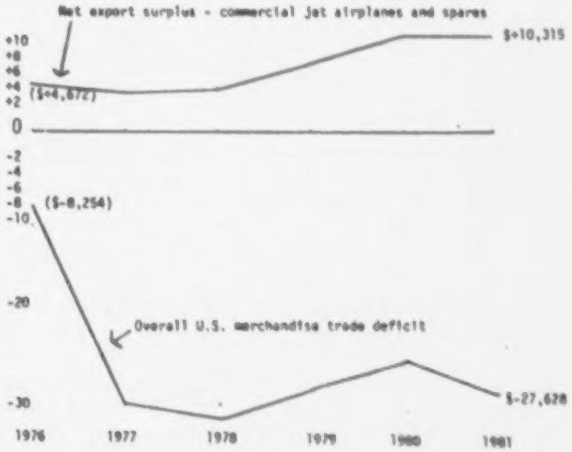
Another beneficial effect of exports is lower unit costs. Development costs can be amortized over more units. As more units are built, increased production efficiencies further reduce unit cost. U.S. airlines benefit and so do U.S. citizens as they enjoy lower air fares and reduced costs for air cargo shipments.

Exports Reduce The Cost Of An Aircraft



Finally, jetliner exports have a large positive effect on the U.S. trade account.

Commercial Aircraft And The U.S. Balance Of Trade



Sources: AIA Facts and Figures 1981/82
U.S. Department of Commerce, ITA, Foreign Trade Annual

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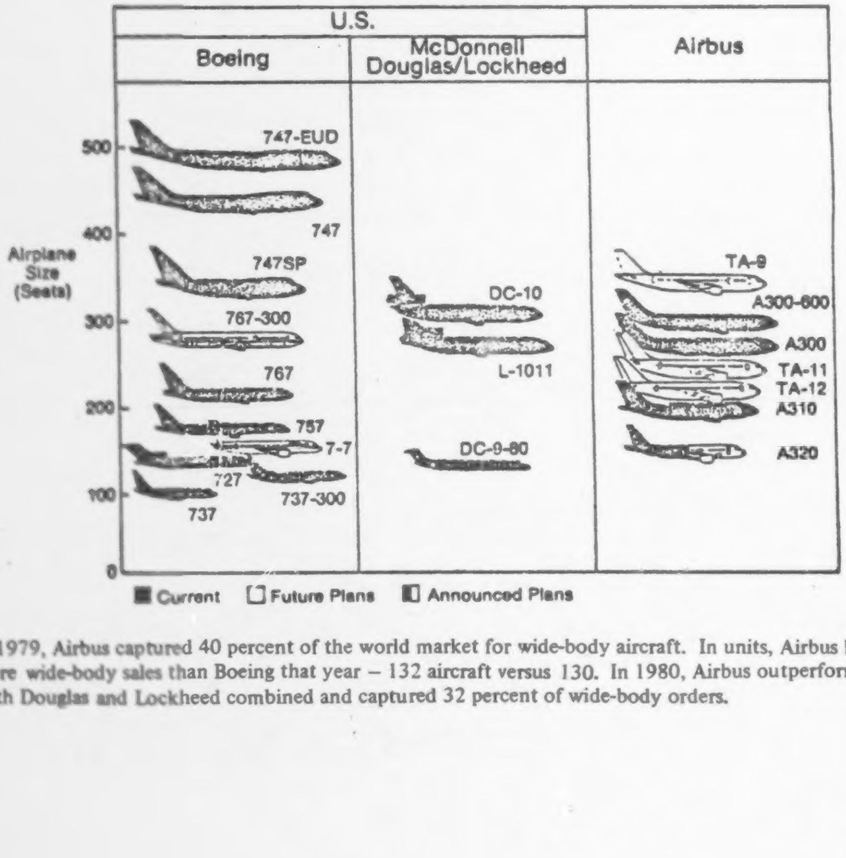
Turning now to the current international environment within which we must operate, there are some disquieting developments that pose a serious challenge to Boeing. They involve both the nature of the overseas competition we face as well as what seems to be a deteriorating international trade policy environment.

Boeing's principal competition is Airbus Industrie, the European consortium composed of Aerospatiale of France, Deutsch Airbus (MBB and VFW-Fokker) of Germany, British Aerospace and CASA of Spain. Aerospatiale and Deutsch Airbus each have a 37.9 percent interest while British Aerospace has a 20 percent interest and CASA a 4.2 percent share. VFW and Fokker, who dissolved their partnership in 1980 are associate members of the A300 and A310 programs, while Belairbus of Belgium is an associate on the A310 program. With the exception of Fokker, all of the companies are fully or partially owned by either their federal governments and/or local state governments.

The production force for the A300/A310 is currently about 12,000 employees and the consortium expects employment to grow to about 28,000-29,000 by 1985.

Airbus competition is a reality across a wide range of aircraft sizes.

Airbus Competition



In 1979, Airbus captured 40 percent of the world market for wide-body aircraft. In units, Airbus had more wide-body sales than Boeing that year – 132 aircraft versus 130. In 1980, Airbus outperformed both Douglas and Lockheed combined and captured 32 percent of wide-body orders.

There are fundamental differences between the European and U.S. economic systems in terms of sources of capital to finance commercial jet transport programs. In the United States, manufacturers like Boeing must rely on retained earnings, equity investments and debt financing for capital investment – in a private enterprise environment involving open competition among alternative investment opportunities. Airbus Industrie, on the other hand, receives a large part of its capital from the national treasuries of the sponsoring governments. The criteria for capital availability is not return on investment nor is the cost of capital necessarily a function of the business/economic cycle. Rather, it is a matter of national policy to fund the development and perpetuation of a high technology aircraft and aerospace industry.

GOVERNMENT AND PRIVATE SECTOR SUPPORT OF COMMERCIAL JET PROGRAMS IN EUROPE AND THE UNITED STATES

			Europe	U.S.
Government Support	Direct Capital Infusion	R&D Funds	●	○
		Developmental Grants		
		—New Programs	●	○
		—Major Derivatives	●	
		Developmental Loans (Low/No Interest)	●	
		Capital Funds for Facilities/Equipment	●	
		Lease or Use of Government Facilities	●	○
		Infusion of Equity Capital into Government-Owned Companies	●	
		Marketing Support and Subsidies	●	
		Exchange (Currency) Subsidies	●	
	Indirect Financial Support	Technology Transfer From Military to Commercial Aircraft Work	○	○
		Government Guarantees for Bank Loans—New Program	●	○
		Government Guarantees for Bank Loans—Company Rescue	●	●
		Tax Credits	●	●
		Airline Financing of New Aircraft		
		—Domestic (Airlines of Producers Countries)	●	
		—Export	●	●
		Training Funds and Support	●	○
		Government-Aided Marketing	●	○
Private Sector Funding		Earned Venture Capital	○	●
		Bank Loans (Not Government Guaranteed)		
		—Developmental Funds	○	●
		—Inventory Financing	○	●
		Company-Financed Research	○	●
		Company-Backed Airline Financing		●

a ● Significant
b Minimal

The international competitive environment for commercial aircraft can be – and has been – grossly distorted by subsidized export credits. Intensive efforts over a number of years to eliminate this distortion have been only partially successful and the current so-called "commonline agreement" is defective in a number of respects.

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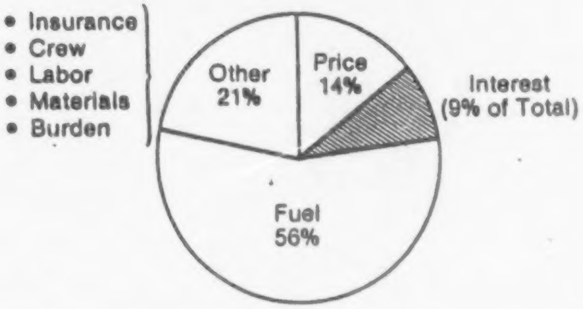
Boeing would like to see all governments get out of the business of subsidizing direct credits and we have taken a leading role within our industry association (AIA) in urging adoption of a new international financial instrument for commercial aircraft patterned on the equipment trust. This proposal is under active consideration by the governments concerned and we are hopeful that our proposal or some variant acceptable to both the U.S. and Europe will be able to prevent a renewed outbreak of an export credit war.

Until we have some new workable and fair system in place to stop competitive export credit subsidies, we must have an adequately-funded U.S. Export-Import Bank ready, willing and able to match credit terms offered by our competitor.

Typical Distribution of Aircraft Life Cycle Cash Direct Operating Costs



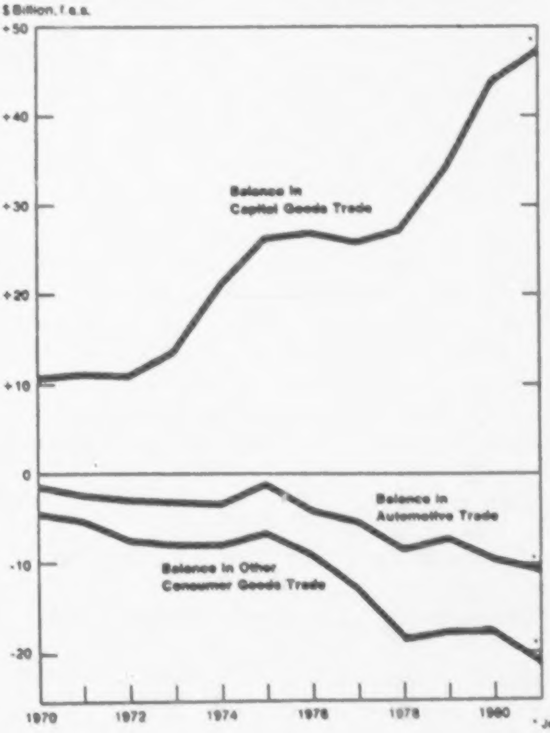
Sales Financing—Big Enough to "Tip the Balance"

This is expecially true when customer airlines experience poor earnings, as has been the case recently. Calculation of the annual cost of purchasing and operating different aircraft is frequently more important in such an environment than total price or technical considerations. Interest costs can be decisive.

The international trade policy environment as well as United States trade policy are always matters of great interest to Boeing, given our dependence on overseas markets. We have consistently supported an American trade policy aimed at keeping markets open for fair competition both in this country and abroad. We have encouraged negotiations to reduce trade barriers and have welcomed the progress achieved over the years in bringing down barriers and improving the discipline over unfair practices.

We know the system isn't perfect. It isn't perfect for Boeing and we know other American business interests have more complaints than we do. But we have very serious reservations about proposals that seem to suggest we should veer off in some entirely new direction, close down the U.S. market to certain products or sectors, single out particular countries someone or another is angry with and strike out at them in a discriminatory fashion. Some of the rhetoric we've heard recently in connection with the new buzzword "reciprocity" seems to suggest bilateral balancing product-by-product or sector-by-sector. If so, it is economic nonsense and a prescription for U.S. and worldwide economic decline. We are opposed to it because we know it would be disastrous for our industry and we believe it would also be so for all the other competitive U.S. exporters – and we shouldn't forget there are still lots of competitive U.S. exporters as can readily be seen by an examination of U.S. trade data. One of the charts submitted to this Subcommittee by the Department of Commerce last fall is particularly instructive:

THE U.S. IS VITALLY DEPENDENT ON CAPITAL GOODS SURPLUS TO OFFSET DEFICITS IN AUTOMOTIVE AND OTHER CONSUMER GOODS TRADE AS WELL AS TO HELP PAY FOR OIL IMPORTS



* January-August 1981 at annual rate.

We believe there is a better course of action open to the United States than turning inward and running the risk of unleashing a trade war. We believe the U.S. Government has considerable scope to press for the reduction and elimination of trade barriers so as to achieve "substantially equivalent competitive opportunities" (SECO) mandated by existing U.S. trade legislation. Negotiations, diligently pursued and aimed at SECO can help keep markets open. The same concept could be used in favor of getting rid of trade distortions caused by export credit subsidies.

Negotiations are the responsible way to deal with trade barriers and distortions that do not violate international agreements, that is to say trade barriers that are "fair" even if disagreeable. Barriers and distortions that violate international agreements, on the other hand, can and should be countered or neutralized. Existing U.S. trade legislation contains an open door for complaints and remedial action against unfair trade practices. We are against unilateral rule-writing by the United States about what is "fair" and "unfair" because more than one can play that game and such an approach invites a downward spiral of retaliation and recrimination.

We are aware that trade in services and trade-distorting investment policies are issues of growing concern and have not been adequately addressed internationally. We would support reasonable additions to U.S. trade legislation so that the Government would have a clear mandate to negotiate appropriate rules in those areas too. We see no reason why such additions need be couched in language threatening retaliation.

The Boeing Company appreciates the responsible manner in which the Trade Subcommittee has always exercised its important functions. We are confident they will continue to be alert to U.S. export interests as they consider proposals for changes in U.S. trade legislation.

Chairman GIBBONS. Thank you, sir. I want to commend you and particularly the Boeing Aircraft Co. for what it has been able to do not only in the development of fine, reliable, high-technology aircraft but what you have done to be able to push your product so well around the world. I feel when I am talking to someone like Boeing that I am talking to the experts in the field, not only of aircraft production but also of foreign trade.

In the absence of any kind of international agreement on export financing, should our countervailing duty laws or section 301 laws be used if foreign subsidized sales take place in this country?

Mr. ROETMAN. I think the history of 301 overall has not been particularly effective. I am sure that its existence serves as some sort of a deterrent. I think in the financing area we have made some progress with the common line agreement expanding on the standstill agreement.

I think that that common line agreement still has a number of defects in it. For instance, we think the 10-year term is too short. When you can spend $100 million for a 747 these days, and the cash flow requirements on a 10-year loan for an asset with a life of something like 18 to 20 years, we think that is not a very good arrangement.

The rate is still concessionary. It involves Government subsidies. We think this is bad, and there are some markets not covered. But at least it is a step, Mr. Chairman. I think Mr. Draper and his people are working very hard to do everything they can to balance Airbus in this area. But I do not see the Eximbank being in a position, at least from our viewpoint, of being able to back off from that marketplace for another couple of years.

Historically, when we have brought out a new product the Eximbank requirements have peaked, but then they have come down again later when the program is well launched.

Chairman GIBBONS. All right, sir. Are you at Boeing satisfied that you are not feeding the people who are eventually going to bite you on competition with your coproduction arrangements?

Mr. ROETMAN. I think to date, yes, sir, Mr. Chairman. One of the advantages—one of the things that maybe makes this business a little bit different than a lot of the others, I think is that to have a successful airplane program, because of the enormous amount of the initial investment—here I am talking in today's environment probably $2 billion as a minimum—there must be a large domestic market.

If you view that, I think you will see there are only two places that have a large domestic market for commercial aircraft. One is the United States; the other is Europe, if you take the European Community as a whole. So far the activities we have had with overseas participants is relatively small. I think on balance it probably has expanded our market.

Chairman GIBBONS. Well, I think before I ask any more questions about that I should tell you I have a report from the General Accounting Office here that is marked "secret." It is entitled "Report to the Committee on Ways and Means: U.S. Military Co-production Programs Assist Japan in Developing its Aircraft Industry." It will be released later on today.

I think it is fair to say that they are going to be pretty critical of the military side of coproduction. Now I have not read the report. I just started reading it when we sat down here. I can see enough already to know that it is going to be pretty critical.

Now that does not mean that it is gospel and I am quite sure everyone will want to study it. It has to be sanitized before it is released just to knock out the classified material. Its conclusion is rather negative.

I know you all are good business people and you want to continue the business profitably and I know you have on the military side some coproduction matters. I would imagine on the military side there is not as much necessity for coproduction as far as financing is concerned as perhaps there is on the commercial side.

Mr. ROETMAN. I think, sir, that on the military side we find that there is greater demand. If we go back to the aircraft agreement under the GATT, the NTM negotiation that went on, we covered only commercial aircraft, so we may have a bigger loophole on the military side of demanding as a condition of purchase that a certain amount of work be placed overseas.

I would like to make one other point that I think is important. In my earlier remarks I mentioned maintaining a technological edge. I do think we have an edge, but I do not think it is a great edge. I do not think the United States has any lock on technology.

If one goes back and traces the history of the commercial aircraft business, the first jet engine came out of Britain. The first four-engine airplane came out of Britain. The first three-engine airplane came out of Britain. The first two-engine airplane came out of France. By two-engine airplane I mean jets. The jet age.

Chairman GIBBONS. Yes.

Mr. Roetman. I think to some extent this great technological leadership is a myth.

Chairman Gibbons. What is it, then, that allows us to have a substantial share of the market if technological leadership is not there?

Mr. Roetman. I think we do have an edge and we want to retain that. I think another edge is, much of it, in our manufacturing, but perhaps the key element in the commercial aircraft industry in getting yourself established in the market is a question of timing and willingness to take risk and putting your development money up front, making your investment early, which is also the reason, of course, this is such a high-risk business.

I think we have an edge in our marketing. We get out. We satisfy the market. We are willing to increase our production rates in the front end of a program rapidly enough to meet the market requirements and get the customers on board, because I am sure in the hearings you have heard that the No. 1 airplane sale to a customer is the key to everything, the key to developing the customer base out there.

If you will look at our competitors, our foreign competitors, historically they have been very slow into the marketplace. One of the things I recollect is the Trident, the first three-engine airplane. The British started some 3 years before we started on the 727, yet they were operationally 6 months ahead of us. Then they had a very gradual buildup and within 1 year of the program start we had more airplanes in the field then they did.

It is a willingness to make a change, to take risk, to get up front and commit.

Chairman Gibbons. That sounds like an exact description of what the Japanese are doing to us with machines.

Mr. Conable. Would you yield, Mr. Chairman? In machines particularly, I go through plants in my district and I see a lot of Japanese machines. I ask why they are buying Japanese machines. The answer is they can get quick delivery on them because they are willing to stockpile them and take some risk. The American machine tool industry cannot deliver for 14 months when they order.

That sounds just like what you are saying about front-end money being critical to the airplane business.

Mr. Roetman. I think that I can make a pretty good case that that has been our situation.

Mr. Conable. Apparently it is not characteristic of all American industry and that is a big reason why we are losing out in some areas.

Mr. Roetman. That is right.

Mr. Conable. It may be attributable to high-interest rates and not being able to borrow the production money up front to take the risk. Obviously that is one of the destroying effects of high-interest rates. It increases the risk and therefore reduces the willingness to take it.

Mr. Roetman. I would not want to leave you gentlemen with the impression that we build inventory airplanes. We only build airplanes to a customer's requirement. We spend the money to get the capacity necessary to meet those customer needs.

Chairman GIBBONS. Without going into the trade secrets of Boeing, is your financing arrangement any different than that of the average American manufacturer?

Mr. ROETMAN. I would doubt it. As a matter of fact, the company has at times been criticized for not financing a larger number of aircraft. Our resources as a private company are limited. We have chosen primarily to put our resources back into product improvements and new programs. We cannot do both. We are not out there financing our product.

Chairman GIBBONS. I am not talking about financing sales. I am talking about financing the production of them. Is your credit any different or your equity structure any different than an average American company?

Mr. ROETMAN. I think, sir, that our cash position—well, I think historically we went through some very bad times in the late 1960's.

Chairman GIBBONS. Yes.

Mr. ROETMAN. Survival itself was an issue for some period of time. I think we have husbanded our resources well since then and before we went into the 757/767 programs we had marshaled—Mr. Haines, our chief financial officer had marshaled some $3.2 billion, as I recall, in cash. It is rapidly disappearing now, but in that sense I think we have been extremely conservative in some of the things that we have done.

Chairman GIBBONS. Well, the reason why I ask these questions is because you are a labor-intensive industrial area, the remarkable success story of being able to compete on an international scale, and somewhere in all of this there is some lesson for all the rest of us.

If you can throw any light on it it would be helpful for us to know. I am not asking you to divulge any of your trade secrets or anything.

Mr. ROETMAN. I am not really knowledgeable enough to make a good comparison with the other industries. Two of the things that the Boeing Co. has done, we have invested an awful lot of money in research and in productivity improvements. I think in the last 4 years we have put some $2 billion of company money into increasing our productivity.

As you have mentioned earlier and are aware, we do procure material all over the world. There are some places that to sell aircraft we must offer some bid opportunities to industries in that country. One of the things we are finding is that almost nowhere, in very few countries, can people in fact—companies—compete with us in this particular industry.

That includes Japan. They are having a very difficult time meeting our cost numbers. In fact, in Europe very few countries can meet our cost figures.

Chairman GIBBONS. To what do you attribute your remarkable productivity within your operation?

Mr. ROETMAN. I think again I can go back to company investment, plant facilities, CAD, CAM, machine tools, an enormous machine shop in Auburn. That has been an ongoing process within the company. It has reinvested a lot of its funds in that area.

How this compares with other companies I am simply not qualified to judge, Mr. Chairman.

Chairman GIBBONS. Well, I have always wanted to come out and look over your operation. I realize it is a very intensive operation and a very successful operation. I probably should admit here that until I found out I had a little trouble in college I had always wanted to be one of your engineers.

Mr. ROETMAN. We would like very much to have you come out.

Chairman GIBBONS. But look where I ended up. [Laughter.]

A number of other things interrupted my career in engineering, but I have admired your work for many, many years and the way you organize and are able to carry out a very productive effort.

So what I say is not being critical. I know you build a fine product and you compete worldwide and you are in a very labor-intensive operation and I think there is a lesson there for all of us. But I frankly really do not understand it. Maybe it is in the sales force. Maybe I have underestimated the sales force.

Mr. ROETMAN. I would like to think that is part of it.

Chairman GIBBONS. We will give you credit for it anyway.

Mr. CONABLE. Sam, at least you are an expert in human engineering.

Chairman GIBBONS. I would not say that, Barber.

Thank you very much for coming.

Our next witness is Mr. Arthur H. Silverman, who is Washington counsel for the Wine Institute.

STATEMENT OF ARTHUR H. SILVERMAN, WASHINGTON COUNSEL, WINE INSTITUTE

Mr. SILVERMAN. Mr. Chairman, I have a short statement. I think it may help set our problem in perspective if I could be permitted to read it.

My name is Arthur H. Silverman. I am Washington counsel for Wine Institute, the trade association of the California winegrowers. We now have 432 member wineries. California-produced wine accounted for 68.8 percent of all wine entering distribution channels in the United States in 1981 and approximately 89 percent of U.S.-produced wine.

Mr. CONABLE. Excuse me. How much?

Mr. SILVERMAN. 68.8 percent.

Chairman GIBBONS. Of all wines?

Mr. SILVERMAN. That would also include imported wines currently being sold in the United States.

Mr. CONABLE. You mean wine sold in the United States. Is his microphone on?

Mr. SILVERMAN. I have a cold.

Chairman GIBBONS. We feel for you.

Mr. SILVERMAN. Again, we accounted for 89 percent of all wine produced in the United States. While this statement is made on behalf of California wine, I am also speaking for the entire American wine industry, which encompasses about 34 States in addition to California.

Unlike the wine industries in many foreign nations, the U.S. wine industry receives no Government aid or subsidy. At the same time, the United States does not impose any nontariff trade obstacles to the entry, distribution, and sale of foreign wines. Thus, American wine competes in our market at no special advantage with wines imported from all over the world, especially from the European Economic Community, and Spain, and Portugal.

Foreign wines move freely in our market subject only to the same laws and regulations which apply to American wines and to the payment of the lowest duties assessed anywhere in the world by a significant wine-producing country on imported wine. I think it is noteworthy that nearly 97 percent of imported wine is subject to duties ranging from 37½ cents per gallon to as low as 21 cents per gallon.

Such easy access has enabled foreign wines to achieve a substantial penetration of the American market. The market share held by imported wines has been on a long and continuing upward trend. Thus, foreign wine sales were only 6.3 percent in 1959, but by 1969 had increased to 10.5 percent. In 1980, they were 21.4 percent, and the figure for 1981 we think will come out very close to 22 percent.

The American market can expect even more attention from the major European wine-producing countries. The harvest for 1980 and, I might add, 1981, produced a staggering 9.3 billion gallons of wine worldwide. France accounted for 1.8 billion. Italy, which has just been selling a tremendous amount of wine in this country, 2.2 billion gallons; Spain 1.1 billion; Portugal, 269 million; all had very large production, accounting just among themselves for 5.37 billion gallons.

I think these figures take on even greater concern when it is realized that the per capita consumption of wine in these major European wine-producing countries has dropped significantly since 1970. The huge quantities of excess wine from these Mediterranean countries resulting from both increasing production and declining domestic consumption will be requiring new markets. It is our belief that our market, which is so readily accessible, will be the prime target.

American wine, and particularly wine produced in California, but other States as well, has achieved worldwide recognition among wine experts. Yet the easy accessibility enjoyed by imported wines in our market is in direct contrast to the export position of the American wine industry in virtually every significant existing and potential foreign wine market. The American winegrower seeking to market his product abroad is faced with a maze of restrictive and prohibitive tariff and nontariff trade barriers.

In 1981, foreign wines with a value of $759 million were imported into this country while the value of our wine exports amounted to only $42 million, resulting in a trade deficit for wine alone of $717 million, which was 2.6 percent of the entire 1981 U.S. trade deficit. Our residents consumed 114.7 million gallons of imported wine in 1981 while U.S. winegrowers sold only 10.7 million gallons of American wine to foreign markets.

We regard EEC countries that are not major wine producers, such as the United Kingdom, as having the potential to be important markets for American wine. Already we are making encouraging progress, despite the trade barriers that we face, in penetrating these markets. However, the EEC duty structure is substantially higher than that of the United States.

The rates vary among the EEC countries, reflecting changes in the relative value of their respective currencies. According to the President's recent report to the Congress, submitted pursuant to the mandate of section 854 of the Trade Agreements Act of 1979, EEC duty rates for bottle grape table wine, the major item of trade for the United States, ranged from 65 cents to 81 cents per gallon. This is 73 to 116 percent more than the 37½ cents per gallon U.S. duty rate.

Moreover, the EEC regulations provide for stringent requirements that must be met relating to processing, labeling, licensing, and certification, all of which we believe substantially impede export trade. Also, a duty surcharge may be levied under certain conditions.

Japan is an extremely attractive potential market for American wines. However—and I am sure it is nothing new to this committee—it has extremely high tariff rates—$5.22 per gallon for bottled grape table wine. In addition, the Japanese impose extremely high excise taxes on wines whose CIF value plus duty exceeds a specified barrier price.

In the Scandanavian countries and Canada, wine is distributed through government agencies, such as the Canadian provincial liquor stores, which handle only a limited number of listed brands. We have found that getting a new item listed for purchase ranges from extremely difficult to, we think, virtually impossible.

The California wine industry, and, indeed, the entire American wine industry, believes that there should be a much greater degree of reciprocity in the treatment accorded U.S. wines by our existing and potential trading partners. We have long been concerned about this lack of reciprocity and have urged that the United States adopt and follow a policy of harmonization through reciprocal tariffs and elimination of nontariff trade barriers.

In support of this position, we participated in the implementation of section 854 of the Trade Agreements Act of 1979, which required a Presidential review of the international trade in alcoholic beverages and a report to the Congress which was to be made not later than January 1, 1982.

Moreover, we have supported technical bilateral negotiations with the European Economic Community. Such negotiations were intended to reach an agreement on the modification or harmonization of those winemaking regulations which tend to impede the international movement of wine.

These talks had made substantial progress until they were—we hope it was just temporary—halted because of the attempt by the administration to scuttle regulatory enforcement of the alcoholic beverage industry. We believe that has been corrected, and that these talks will now proceed.

We are extremely gratified by the increasing international acceptance and recognition of our best wines. This acceptance and recognition is given credence by the progress many of our wineries are making despite frustrating trade barriers in the export market.

The large percentage increases of the past 2 years in shipments to certain countries, while impressive, are misleading because they result from a very small base. Nevertheless, our exports have increased from slightly over 1 million gallons in 1975 to 10.7 million gallons in 1981.

Canada has long been our leading customer, taking over half of our total wine exports. The United Kingdom received 1.1 million gallons in 1981 and several other countries were in the one-quarter to one-half million gallon range. While these are small numbers in the world wine trade, they are significant to us because they represent both progress and potential. The realization of that potential is our objective and this is highly dependent on what happens in the area of reducing trade barriers.

Mr. Chairman, we respectfully urge this committee to render all necessary assistance to the American wine industry to ameliorate in international wine made what we consider to be a classic case of inequity.

Thank you very much.

Chairman GIBBONS. You brought up a very interesting field. I realize that probably next to agriculture the alcoholic beverage industry is unique in the different areas of world trade than anything else for a lot of historic reasons.

I guess we are just slowly dismantling barriers in your industry. Eventually we are going to have to sit down at some kind of international table and bargain back and forth on these matters.

Mr. Conable.

Mr. CONABLE. Mr. Chairman, I would like to ask Mr. Silverman if the wine convention is not a major nontariff barrier for us. We cannot sell anything called Champagne or Burgundy or any other similar type of wine in the European market or in many of the Third World markets that support the wine convention, even though they do not produce wine.

Is there any way we can crack that?

Mr. SILVERMAN. Mr. Conable, the Madrid agreement and the wine convention you have been referring to are indeed problems, but they are not the major problem. What has happened, as Mr. Conable mentioned, is that a particular generic designation will be reserved to a product, say, from France.

Mr. CONABLE. I cannot hear you, sir.

Mr. SILVERMAN. I am sorry. Your reference to the Madrid agreement and these other wine conventions, while they pose a problem, really today are far from the main problem. These conventions would prohibit the exportation by any country who is a signatory to the agreement of, let us say, a product designated "Burgundy." A Burgundy wine would be reserved to a product of France, Chablis to a product of Spain, et cetera.

Most of our wines today are of the varietal nature—a wine named after a specific grape such as Cabernet Sauvignon, or the white wine—Chardonay, et cetera. Our problems have to do with the classic duty problems and nontariff barriers. We have not attempted probably, I would say, in the last 10 years to make an issue of this Madrid agreement. The United States is not a signatory to it.

Mr. CONABLE. We never have been.

Mr. SILVERMAN. No.

Mr. **Conable**. That, in your view, is not the major problem? The problem is more tariffs?

Mr. **Silverman**. Yes, tariffs and nontariff barriers.

Mr. **Conable**. In dealing with Japan you in California would have a difficult time. The cost is very high and it is a result of tariff and internal tax, from what you say.

Has any serious effort been made in the course of MTN or otherwise to try to get tariffs down?

Mr. **Silverman**. We have tried. I might add that our problems around the world are trade barriers, both tariff and nontariff. In Japan we tried, pursuant to the 1979 MTN consultations. Some progress was made. There was a mild reduction in the duty rates in Japan, but with the fluctuating currencies it has not been a signficant amount and it has not enabled us to achieve much more penetration into Japan.

Mr. **Conable**. I would call your attention to that and urge you to correct that. Of course—the world is not a bilateral world, it is a multilateral world. But that is an area where we have a very severe trade deficit. Where in Europe, where you say great wine production occurs and where you have serious obstacles also, we have a very large surplus in dealing with them.

So it is the nature of a vacuum and more deficit. I would hope you would try to fill that deficit with more wine over to the east.

Mr. **Silverman**. We are working very closely right now with the administration to try to resolve some of the problems we have with the Japanese.

Mr. **Conable**. Thank you very much.

Chairman **Gibbons**. Mr. Pease.

Mr. **Pease**. No, thank you.

Chairman **Gibbons**. Thank you.

Our next witness is Mr. David J. Steinberg, president, U.S. Council for an Open World Economy.

STATEMENT OF DAVID J. STEINBERG, PRESIDENT, U.S. COUNCIL FOR AN OPEN WORLD ECONOMY, INC.

Mr. **Steinberg**. Good afternoon, Mr. Chairman, Mr. Conable, Mr. Pease. Our council is a public interest organization engaged in research and public education on the merits and the problems of achieving an open international economic system in the overall public interest. We do not speak for any corporations or anyone else affected in any way by trade policy issues.

I want to be very brief, Mr. Chairman, and highlight just a few of the points that I think deserve emphasis in our statement this afternoon.

As you will note, we put a title on it. We said what is needed is a free-trade strategy, not just a free-trade stance. What we mean is that a lot of people are self-styled free traders, but when you really put the question to them directly, do you advocate free trade, I dare say there are extremely few who say they advocate free trade.

We hear that the current administration in Washington is in favor of market forces. That is most commendable, but being for free trade and market forces, it seems to me, goes with the White House territory. What is needed is a deliberate American initiative to invite the industrialized countries of the free world to join with us in negotiating a free trade charter calling for the removal of all forms of impediments to trade, services, capital access, et cetera, in accordance with a realistic timetable.

For some products and some kinds of transactions that timetable may have to stretch over the remaining years of this century, but at least let's set up a program. We may never achieve the promised land of complete free trade even on the part of the industrialized countries, but I think that great progress can be made toward that worthy objective if we undertake to negotiate a free trade charter.

This charter would provide the underdeveloped countries the same access to the markets of the advanced countries that the participating advanced countries would accord to one another. But we could not expect equivalent reciprocity from the developing countries. However, I would not let them off the hook. They would have to make commitments also.

One of the features of such a charter would be a policy area that, as I recall, was mandated in the Trade Act of 1974, but of which I have heard nothing since. That is the need for equitable access to critical raw materials produced around the world. I think that countries, certainly the underdeveloped countries, participating in such a free-trade charter as I am advocating should be called upon to make commitments to provide the world economy equitable access to critical materials that are produced in these areas.

A lot of progress has been made toward removing trade barriers, but there are a lot of barriers that remain. There are a lot of barriers that are not touched by trade negotiations, certainly attitudes on the part of governments and private citizens.

There is a need to reform the whole code of fair international competition to make sure that it is fully equitable, but I submit, Mr. Chairman, that we are not going to get as far as we should go in reforming the code of fair competition unless there is the spur, the stimulus of a definitive free-trade strategy.

Surely we cannot achieve free trade without completely fair trade, and I submit that it also applies the other way around. We are not going to be able to achieve completely fair trade unless there is a stimulus of completely free trade. There are some people who say they are not advocating free trade; they are for fair trade. There are some people who say they are for freer trade, but have doubts about fair trade because they are fearful of the protectionist undertones and overtones in the use of the term "fair trade."

I submit that free trade and fair trade are one policy, indivisible. We have to go after both of them together. They are both very closely interrelated.

There is also a need for a more coherent, more deliberate effort in the area of redevelopment of the American economy, what some people have called reindustrialization. But I hear very little about the kind of trade policy premise that should be cranked into such reindustrialization. I submit, Mr. Chairman and gentlemen, that the best kind of trade policy premise to crank into reindustrialization or the redevelopment of the American economy is a deliberate free-trade premise.

We need an adequate adjustment policy, but a convincing commitment to full employment ought to be an important ingredient of such a domestic adjustment strategy.

Now I would like just to make one more comment this afternoon, touching on one of the major points in my testimony. That is the need to reform the escape clause, the so-called import relief section of the Trade Act. I think that the escape clause is, to a certain extent, a pig in a poke. An industry that convinces the Government that it needs and deserves import restriction is not called on by the Government to make a definitive commitment as to what it proposes to do during this transition period.

The industry may justify its needs for import restriction and if this has the sanction of the International Trade Commission and of the President himself, then what the Government seems to be saying to the industry is: "Here is the import restriction you said you wanted. Good luck." But the American people do not know, even in broad terms, what use is going to be made of this subsidy, for surely it is a subsidy.

There should be a positive commitment by the industry concerned as to what it will do. The industry should be held accountable for the details of this commitment. We should not just rest back on the passive expectation that oh, well, the industry will do the right thing behind the import restriction it says it needs.

Therefore, I think that the United States ought to as quickly as possible revise its escape clause provision to require that any import restriction found to be justifiable will be provided only as one component of a coherent, comprehensive industry redevelopment strategy addressing the real problems and the real needs of the petitioning industry at this point in time, the closing years of this century.

I think this is the kind of import relief standard that we ought to be trying to get adopted by the general agreement on tariffs and trade to apply multilaterally to all countries that subscribe to the GATT. We hear a lot of talk about the need to negotiate new safeguards standards, but I hear very little discussion of what that standard should be and I submit to your committee this afternoon, Mr. Chairman, that in the briefest terms the kind of standard I think is necessary at this time is what I have just outlined to you.

I will conclude my oral remarks with that. I thank you very much.

[The prepared statement follows:]

STATEMENT OF DAVID J. STEINBERG, PRESIDENT, U.S. COUNCIL FOR AN OPEN WORLD ECONOMY, INC.

NEEDED: A FREE-TRADE STRATEGY, NOT JUST A FREE-TRADE STANCE

The U.S. Council for an Open World Economy is a private, non-profit organization engaged in research and public education on the merits and problems of achieving an open international economic system in the overall national interest. This testimony advocates a coherent free-trade strategy as the best possible trade-policy premise for U.S. economic advancement, and as an indispensable step toward the most far-reaching, most equitable reform of the code of fair international competiton. Its other proposals include reform of the important-relief provisions of U.S. trade-policy administration, integrating import relief into coherent industry-redevelopment strategies.

POLICY SHORTCOMINGS

Our country's understanding of the importance of freer, greater two-way international trade to its economic health and national security has come a long way from the idiotic trade policy of 1930, even since the more enlightened policy of the early post-World War II period. But progress in reducing trade barriers is erratic. Old barriers have come down, but many remain and new ones go up. With rare exceptions, other countries are no better in this regard, most of them worse. Progress toward free trade—more broadly, toward an open world economy—is retarded by absence of a definitive, deliberate, dependable strategy to achieve this ultimate objective. Lack of free-trade charter of rights and obligations in fact contributes to loss of ground as industrial crises evoke corrective measures not adequately disciplined by strict, well-structured international rules to which most (ideally all) governments are committed.

In virtually every instance, in this country and perhaps everywhere else, where imports are restricted to help an ailing industry, such controls are not components of balanced, coherent industry-redevelopment strategies addressing the real problems of the affected industries—strategies to which these industries are explicitly committed and for which they are held strictly accountable. A new "safeguard" mechanism (failure to negotiate one remains a major failing of multilateral trade deliberations) needs to be adopted, requiring an industry-redevelopment framework for whatever import restraints may temporarily be justifiable.

Trade restrictions through international negotiation or consultation have become fashionable; negotiated or "voluntary" export controls, deemed preferable to unilateral import curbs (especially those threatened by legislatures), have acquired a respectability they do not deserve. Lack of industry-redevelopment commitments is only one of their faults.

The code of fair international competition is a patch quilt of patched-up standards that do not aggregate a totally reformed, fully equitable set of rules capable of confining government restriction of legitimate international business to carefully defined measures of last resort in adjustment strategies that address the real problems of industries deserving government help. International rules regarding other areas of international business (for example, services, export financing, foreign investment) are treated as segmented subjects, not as parts of a coherent, comprehensive charter through which maximum equity and reciprocity can be secured, both within each sector and encompassing the entire range of international transactions.

Another disturbing phenomenon is that some of the very people (in and out of government) who decry "protectionism" are not above demanding or condoning import restrictions in tit-for-tat retaliation against foreign barriers impeding U.S. transactions, or asking government to threaten such measures to induce those countries to lower their barriers in compliance with U.S. wishes. Whatever the occasional equity of retaliatory maneuvers, a more constructive, more sophisticated, more far-sighted, indeed more daring, policy initiative is needed to get trade barriers and other distortions removed. The U.S. government is not prepared for the free-trade strategy that should highlight such an effort, nor for the domestic-policy initiatives needed to backstop it—to make it attainable and sustainable.

There are also serious deficiencies in the international-trade performance of too many U.S. corporations, either in adjusting to import competition or engaging in export promotion. In fact, the shortcomings of government policy tend to induce shortcomings in business performance. If government set a firm, credible course toward an open world economy, industry would respond more impressively in market performance at home and abroad. The uncertainties in government policy breed uncertainties in business policy, with the result that the system does not operate as well as it could and should in both domestic and international trade. A national policy to open the U.S. economy to the freest flow of imports (with appropriate protection against unfair competition), and to open foreign markets to the freest flow of U.S. exports (with carefully defined exceptions in the reciprocity offered by underdeveloped countries), would make an all-out effort at export expansion and at coping effectively with import competition the priority commitment it ought to be in the planning portfolios of U.S. producers. Notwithstanding the rhetoric about our national commitment to "freer trade," a definitive free-trade premise is not cranked into the decision-making of government and business. It is conspicuously absent, for example, from highly touted, greatly needed efforts to increase productivity, combat inflation and expand exports. The government's plans in trade policy are not where its rhetoric is, and still further, of course, from where its rhetoric ought to be.

The Administration's recent White Paper on trade policy stressed the importance of open markets at home and abroad to developing a strong U.S. economy. It pledged reliance on market forces to facilitate adjustment to problems of dislocation. A decade ago, another President included a comparable pledge in his State of the World message to Congress: "This Administration is committed to the principles of free trade . . . A continued liberal trade policy is indispensable to our domestic economic health and to a successful U.S. foreign policy." Being for "free trade" seems to go with the territory, yet there has never been a credible commitment to that objective. Although another major round of trade negotiations was successfully concluded in the late 1970's, international commercial channels, even between the economically advanced countries are clogged with a wide assortment of artificial barriers. There is no coherent, convincing strategy to remove these obstructions and prevent new ones. To cite only one area of nontariff devices, there is no assurance that measures to protect importing countries against unfair competition (for example, measures dealing with dumping and subsidies) will not be made a minefield to undermine legitimate forms of aggressive trade promotion.

The pledged reliance on market forces had a commendable ring to it but turned out to be more a philosophical or ideological doctrine than a productive view of policy realities and imperatives. This impression seemed to be confirmed by the statement of the Chairman of the Council of Economic Advisers in Senate hearings that adjustment assistance should go to individual workers, not industries. His testimony showed no awareness of the circumstances under which ailing industries may merit government assistance (including regulatory reform) without the government continually subsidizing those that may be incapable of viability on their own (except for industries needed for legitimate national-security purposes).

FAIR TRADE/FREE TRADE

Many have referred to "fair trade" as the goal to be sought, not "free trade." They see "fair trade" as a practical, down-to-earth objective, "free trade" as a fanciful theory. Others like the concept of "free trade" (although most shy away from a definitive policy to achieve it) and the ideal of "fair trade" too, but they not unreasonably suspect protectionist undertones in the way "fair trade" has come to be used in many quarters. The fact is that free and truly fair international trade are inextricable essential one to the other. Fully fair trade, covering all the rules of fair international competition (and of equitable international business in the broadest sense), will not come without the spur provided by programming fully free trade—an initiative that would dramatize the urgency of thoroughly reforming the code of fair international competition and ensuring the fullest reciprocity. Conversely, fully free trade cannot be sought, secured and sustained without commensurate steps toward fully fair trade. "Free and fair" international trade—one policy, indivisible—is thus a more meaningful and constructive proposition than its detractors on all sides of the trade-policy spectrum recognize. It fosters the ultimate in reciprocity.

TIME FOR A FREE-TRADE STRATEGY

The time has come for a definitive strategy to program the phasing-out of all artificial barriers and distortions by the economically advanced countries on trade and other transactions, and construction of a fully equitable code of conduct encompassing all forms of international business. New rounds of international negotiation on such matters as service transactions, export financing, foreign investment, a new "safeguard" mechanism and other trade issues here and there—such piecemeal efforts are not enough. Some progress can be made in this fashion in each of these sectors but, without a comprehensive free-trade initiative embracing all sectors of international business relations, it will fall far short of what is needed.

A free-trade charter as here defined would tend to ensure full reciprocity on trade and each of the other sectors, and all fields collectively. This prospect, in turn, would generate support for a negotiating effort of this magnitude.

The free-trade timetable may have to be exceptionally long for certain products, maybe to the year 2000 in a few cases. Departures from the timetable may occasionally be necessary to deal with unforeseen emergencies, but strict criteria should govern such deviations. The promised land of total elimination of trade distortions (even by the economically most advanced countries) may be indefinitely (some may say eternally) elusive. But a definitive commitment to this objective, and to the domestic policies needed to backstop such a commitment, is practical and can be made politically palatable.

The United States should make clear its readiness to negotiate a free-trade charter with as many industrialized countries as may now care to go this route—leaving the door open to those who may not be reluctant (their reluctance would deny them the same access to countries of the free-trade area as that accorded by member countries to one another). Raising the world's sights to what needs to be done, and declaring our readiness to participate, will sooner or later energize universal resolve to achieve this goal. Setting a timetable for removing barriers and distortions may tend to accelerate the timetable.

Among other benefits, this is the framework within which we stand our best chance of resolving the severe problems now besetting our economic relations with Japan and the European Community. There is no time to lose in giving these and other foreign-economic crises our "best shot." A strategy that is radically progressive is the best response to pressures and prospects that are radically regressive (the threat best known as "protectionism"), even though the difficulties of carrying out such a strategy are monumental.

Another important component of such an initiative is the need to remove barriers to our imports from the underdeveloped countries (in step with similar moves by other developed countries) without requiring the kind of reciprocity we would expect from the industrialized countries joining us in the proposed strategy. Some developing countries will reach reciprocity capacity much sooner than others, but in virtually all cases the Third World timetable for reciprocal free trade (or anything close to it) will be infinitely longer than for advanced countries, actually defying definition. In no case, however, should the developing countries be given a completely "free ride," devoid of appropriate commitments in their treatment of foreign goods, services and capital.

The Third World dimension poses more than moral issue—the obligation of rich to poor. There is also a much neglected national-security issue—the threat to world peace from festering poverty, population explosion and explosive frustration. There is also a threat to our economic well-being if we are denied access to the Third World's critical raw materials at reasonable, rational prices—a problem likely to become more critical unless the world's North and South engage in a more constructive, more productive dialogue than thus far has occurred. This access question was given considerable attention in Congressional consideration of the Trade Act of 1974. But the need to include this matter in trade negotiations (the statute mandated such attention) has been neglected except, it appears, for our Council's outspoken concern about it. This issue merits high priority in a new initiative dealing with North-South trade development.

The new relationship we should be building with the underdeveloped countries also involves a vast market opportunity for our exports. The emerging trade pattern we must envisage much more clearly is more than the exchange of our high-technology and agricultural exports for their raw materials and simple manufactures. The pattern for which we must plan is trade in all kinds of goods which exporters want to sell and consumers want to buy.

Programmed removal of all trade barriers affecting imports by the industrialized countries from all sources would bring great benefits to the developing countries even in the face of stiff competition from advanced countries in certain products. The gains may be even greater than those resulting from current policies of preferential zero-tariffs on certain imports from developing countries, especially when one considers the substantial stimulus which the prospect of total free trade would give to the ingenuity, growth and import potential of the industrialized countries.

The United States may stand for market forces in general and for "free trade" in its trade policy. However, we need more than a stance in this policy area. We need a strategy.

ADJUSTMENT STRATEGY

Essential to securing and sustaining a genuinely free-trade policy is a coherent, convincing national strategy to help ensure the orderly adjustment of American industry, agriculture and labor to substantially and consistently freer world trade in an increasingly competitive and interdependent world. A credible commitment to full employment is a major ingredient. There is still no adjustment strategy capable of reassuring the many millions of Americans who have become apprehensive about America's position in a rapidly and radically changing world economy. Without such a strategy, addressing the real problems of ailing sectors of our economy through close cooperation of government and private enterprise, there is reason for deep concern over how much progress can be made in pruning the heavy thicket of trade barriers. The present concept of adjustment assistance is inadequate.

Another neglected adjustment issue is the need for government attention to the adjustment problems of businesses that may be adversely affected, not by imports, but by the government's restriction of imports. There are jobs and investments that depend on international trade as well as those that may be adversely affected by international trade. Those hurt by government decisions restricting trade are no less deserving of adjustment help than those hurt by government policies liberalizing trade.

The adjustment strategy necessary to backstop an authentic free-trade policy should be part of an overall domestic-development strategy covering urban renewal, transportation reform, improved productivity and other programs essential to solving the nation's problems at home and increasing its effectiveness in world markets. A new frontier of American economic advancement is at hand. Full appreciation of this prospect and of its potential for sound and steady economic growth would stimulate business confidence in the outlook for good returns on heavy new investments. Anticipation of free trade would spur redevelopment.

REFORM THE "ESCAPE CLAUSE"

One area of adjustment policy that merits immediate attention quite aside from a free-trade initiative is the "escape clause" or import relief provision of the trade legislation, and the corresponding "safeguard" mechanism of the General Agreement on Tariffs and Trade. The international community is not adequately addressing this issue. Nor is the United States.

When industries can prove they merit import relief, the only related question now decided in extending aid to the whole industry is how, how much and how long such relief should be accorded. Import relief is supposed to buy time for industry adjustment efforts, but it has never been conditioned on detailed programs to solve the real problems of these industries in the context of the total national interest. The same can be said of specific-industry Buy American requirements (e.g., on textiles and specialty metals) in defense procurement. Trade restrictions outside the framework of coherent industry-redevelopment strategies (virtually all trade restrictions are) tend to divert attention from the full range of things that ought to be done to solve the problems that inspired the quests for import controls.

If import controls are to be imposed by whatever means (including international negotiation), the American people have a right to know for what clearly defined purpose these subsidies are required. The time has come to reform the pig-in-a-poke approach that for too long has characterized the handling of import controls. Import controls should not be imposed in some vague hope that the industry will use this adjustment time for soundly based adjustment efforts. Clear delineation of such adjustment plans, with full public accountability, should be a condition, a required framework, for whatever import restriction is established. Thus, the nation that provides help to a deserving industry should insist on a positive commitment, not be satisfied with a passive expectation—expectation that the help provided at public expense will be used productively for the public good. Trade control to buy adjustment time should be a measure of last resort, be as little as possible and be terminated as soon as possible.

Such an approach seems consistent with a liberal interpretation of the following view in the Administration's trade-policy White Paper: "It will be critical to encourage . . . all governments to adopt adjustment policies which do not have trade and investment distorting effects." We should be seeking a new "safeguard" mechanism that reflects these principles. No such effort is evident.

This long overdue reform in the handling of "escape clause" cases is not in conflict with existing legislation. Section 201(b)(5) of the Trade Act of 1974 (a provision whose scope has been neglected in trade-policy administration) requires assessment of the petitioning industry's effort to adjust to import competition. By implication, this calls for (at least invites) assessment of government policies materially affecting the industry's ability to adjust, and correction of any statutory or regulatory inequities found to be impairing such adjustment. Such action is an essential component of balanced adjustment assistance to a deserving industry, whether or not import restriction is also provided.

The adjustment-policy framework outlined above should be mandated explicitly by statute. However, there is much the President (with the help of the International Trade Commission and appropriate executive agencies) can do along these lines on his own initiative, as I have suggested many times in Congressional hearings.

Chairman GIBBONS. What kind of an adjustment assistance program do you think we ought to have?

Mr. STEINBERG. Certainly, I think it ought to have a very heavy emphasis on retraining. I think that is the message that we get downtown from the administration. I think that is important.

Once you have trained somebody, is there a job there into which this retrained person can move? Therefore, the adjustment assistance program, the trade adjustment assistance program, should really be only one part of a comprehensive national economic development program within which we generate jobs into which retrained individuals can move.

This, I submit, Mr. Chairman, is very general thinking. I do not have statistics on the amount of money that should go into this sort of thing. But certainly, retraining and jobs into which retrained people can have a convincing assurance of moving, certainly are essential to an adequate adjustment program.

Mr. Conable. Mr. Steinberg, I am afraid what you are saying about free trade is not going to solve the problem necessarily. As we have gone along and reduced our tariff barriers, we found a great growth of nontariff barriers, many of which are not the same in form and yet are increasingly providing restrictions outside of the kind of commitment you are seeking, really.

We would have to have, of course, continued negotiations about these regardless of the total sincerity of the commitment to free trade in tariff sense.

Mr. Steinberg. I am not just concerned with tariffs, Mr. Conable. I am concerned with all kinds of impediments to the movement of goods, to services, to the movement of capital. I fully realize the problems we have even in trying to get compliance with the rules that have already been negotiated.

But I think there is a lot of uncertainty in the world. I think there is a lot of uncertainty in Japan, for instance, as to where the world economy is really going. I think people generally are less than confident that the world economy is really moving toward a genuinely freer trade policy.

We have made a lot of progress, but, by the same token, on this very slippery pole, new trade restrictions have come into being. Negotiated agreements have come into being. Negotiated restrictive agreements, which gain a certain respectability they do not deserve.

I think we have to cope with the entire range of impediments to international business transactions now. I have no illusions as to how the rest of the world would react if the President of the United States sent a message to the forthcoming meeting of trade ministers, saying the United States is committed to seeking the kind of trade policy that I have this afternoon outlined in this testimony.

Maybe no other country would accept our invitation to join with the United States in forming a free-trade area under the rules of GATT, but I think that if we put this kind of proposition on the table, it would have an electrifying effect around the world. It would raise the sights of people around the world, including the sights of the American people themselves, as to what it is we are really trying to achieve.

I think we will gain a lot more in the area of reciprocity, a lot more in dealing with the entire range of impediments to international business by what I have called a radical progressive, very daring idea then we have succeeded in achieving with the trade policy we have had to date.

Chairman **Gibbons**. Thank you, sir. We appreciate your coming here and helping us today.

Mr. **Steinberg**. Thank you very much.

Chairman **Gibbons**. The next witness is Dr. Peter Nelsen, president of the Agricultural Trade Council.

STATEMENT OF PETER NELSEN, PRESIDENT, AGRICULTURAL TRADE COUNCIL

Mr. **Nelsen**. Mr. Chairman, Mr. Conable, Mr. Pease, thank you for this opportunity to address you again. If our statement may be entered in the record, I will just summarize.

Chairman **Gibbons**. Yes; all statements today will be entered in the record.

Mr. **Nelsen**. We were here before. Rather than repeating what I said before, I will be very brief.

In the Export Administration Act of 1979 there was a good statement that started the congressional findings. And I quote: "The ability of the United States citizen to engage in international commerce is a fundamental concern of United States policy."

That summarizes what the administration has been saying for the last 20 years or so, both Republicans and Democrats. However, the actual effect of that statement has been hard to find in some years. To bring the whole issue up to date, we all know the present problems that we are having in industry, the high unemployment, the high deficits, that we find in the national budget. Export seems to be the only way to solve those problems in the near future.

It is our estimate, based on a good economic model that ATC has developed, that a 10- to 11-percent increase in U.S. exports would eliminate half of our foreign trade deficit. It would reduce our domestic unemployment from 9.5 to about 5 percent. And it would reduce our budget deficit by 18 to 20 percent.

That is staggering to most of the people I have discussed it with lately. If you look at the GNP, an increase in our exports of 10 percent of both manufactured products and services would result in a growth of 1.5 percent in our GNP and would thus create the confidence needed to attract new investment in plant and equipment, which has been thoroughly lacking even with the incentives that the current Reagan budget has tried to induce.

Now, how would we attain this? The problems have been well stated by the speakers that you had a couple of months ago, just before Christmas. Rather than try to repeat them here, briefly the most important one is credit, export credits. The gentleman from Boeing put it well. I can add a few figures to it.

Chairman **Gibbons**. Would you pull the microphone a little closer to you?

Mr. **Nelsen**. Japan subsidizes about 35 percent of their exports with financing, provides financing for about 35 percent of the exports.

Chairman **Gibbons**. Are you talking about agricultural exports?

Mr. **Nelsen**. I am talking about across the board now. France, about 30 percent, and the United States about 6 percent. In the world market—and I am speaking not only of agricultural commodities, because our association represents companies that manufacture agribusiness equipment, farm machinery, farm buildings, and all kinds of food production-related commodities.

Mr. **Conable.** Do we not subsidize agricultural exports more than we do industrial?

Mr. **Nelsen.** Yes, we do, quite a bit. But it is only certain commodities. There are about 58 commodities out of 205 that receive subsidies. In many commodities, both agricultural and industrial, the difference in getting or not getting an order on the world market is often the credit terms. Many of those products really do not differ significantly.

If a Third World country wants to buy a spade or a shovel, they are very similar whether they come from the United States or somewhere else, if they have to put up the money 3 months in advance with a letter of credit, 3 months in advance of the time they get delivery and can sell the things, they are certainly going to give preference to someone who can give them a credit and payment against delivery or within 30 days after delivery.

The answer to those problems lies not only in direct credit terms but also in the cooperation that an exporter can get from the Government in obtaining credit information. If you get an inquiry from overseas and you want to respond to that inquiry finding out that you are dealing with a creditworthy company, you can afford to do better than if you never heard of those people.

We have a method by which the embassy is supposed to give us credit information if you pay $10. Usually, you wait 2 or 3 weeks. By that time, they might very well have bought from a Canadian competitor, an English competitor, or someone elsewhere.

There are many services that could be provided that do not impact on the budget directly but simply affect the services that the Government is able to supply in an expeditious manner.

Let me talk about embargos briefly, because I am probably the only one here who will talk for agriculture. Since all bills are voted by the entire floor and not only the Agriculture Committee, it is important that you recognize that it is absolutely unfair to put embargos on agricultural commodities only. From a humanitarian point of view, it is inexcusable. Why not embargo industrial equipment? It has much more strategic value to the country that we are trying to reprimand or hurt.

In a geopolitical sense, the farmer has been taking the brunt of political policy of the United States in this area, and there is very little justification for it. Certainly, I have not been able to find any. I would just like for you to think about that. I can talk about it for hours, but it just seems so self-evident that it should not need any further clarification.

There is a bill now to reimburse a farmer for any loss due to an agricultural embargo, but the implementation of an agricultural embargo at this time would both be costly to the economy and also rather inexcusable to Third World countries that we are trying to make friends with.

Speaking of Third World countries we all know about the basic 12 minerals that we are totally relying on Third World countries for to maintain our industry.

Our testimony covers briefly a triage principle where we can divide the world into three groups of countries: First there are those who are friends and are trading partners and those who are our allies militarily, and those who can maintain their own economic and agricultural production.

There is the second group, those that can be helped either because they have the infrastructure or the natural resources to become self-sufficient or because they are so important to the United States that it is incumbent upon us to supply them in order to maintain a friendly relationship.

Then there is a third group of the triage set. Those are the ones that are constantly throwing brickbats at us politically and who really cannot be helped with their food production due to lack of resources, capital, or infrastructure.

We should rank these countries with a clearly defined policy so that we know who we can rely upon for what we need and they know that they can rely or not rely on us.

The effect of such a policy would have much greater benefit to us geopolitically than military assistance and some of the other programs that have been used.

Last, let me just talk about the current credit market, which again, well, it was mentioned earlier, but to effect an increase in productivity and exports, we need credit domestically, as the man from Boeing said, to stockpile so that we can deliver in a reasonable time.

The past administrations have covered the deficit by printing money. This was thrown out, and we are now covering our budget deficit by going to the market. It is abysmal to look at a potential $100 billion deficit, and the anticipation of competing against the Government in the Wall Street market is discounting any confidence that the economy needs to recover.

It may not be appropriate for this committee to consider this, it falls partly on the administration, partly on the Federal Reserve Bank, it has to do with our overall policy of both export and domestic trade. We need a balance between printing money and going to the market so that the administration can cover their budget and at the same time not deplete or rape the money market.

If credit stays at 18 or 20 percent, you are going to have a long-term deflation domestically and in the world market. And the danger in the long run is that deflation in the Third World countries, which are much more affected than we are, in the long run will start a world depression.

It is said that when we have a cold here they get pneumonia in Africa. No one takes that very seriously, but if you look at the facts it is very serious.

With those comments, I thank you very much for your attention.

[The prepared statement follows:]

STATEMENT OF PETER NELSEN, PRESIDENT, AGRICULTURAL TRADE COUNCIL

Mr. Chairman and Members of the Committee. We thank you for this opportunity to submit testimony before the Ways and Means Committee's Subcommittee on Trade.

I am Dr. Peter Nelsen, an economist and President of the Agricultural Trade Council (ATC) and Chairman of the Agricultural Research and Development Institute (ARDI).

At this time of stress on the domestic economy when development of free world trade markets is vital, this committee has the opportunity for substantive assistance for the United States economy.

In times of domestic economic uncertainty, it is natural to look for a scapegoat and foreign trade has been an easy target for protectionism and restrictive legislation; although such legislation is generally not in the best interest of any segment of the Unites States economy. The facts of the matter were well defined in the Export Administration Act of 1979 and we quote them herein:

"Sec. 2. The Congress makes the following findings:

"(1) The ability of United States citizens to engage in international commerce is a fundamental concern of United States policy.

"(2) Exports contribute significantly to the economic well-being of the United States and the stability of the world economy by increasing employment and production in the United States, and by strengthening the trade balance and the value of the United States dollar, thereby reducing inflation. The restriction of exports from the United States can have serious adverse effects on the balance of payments and on domestic employment, particularly when restrictions applied by the United States are more extensive than those imposed by other countries.

"(3) It is important for the national interest of the United States that both the private sector and the Federal Government place a high priority on exports, which would strengthen the Nation's economy.

"(4) The availability of certain materials at home and abroad varies so that the quantity and composition of United States exports and their distribution among importing countries may affect the welfare of the domestic economy and may have an important bearing upon fulfillment of the foreign policy of the United States.

"(5) Exports of goods or technology without regard to whether they make a significant contribution to the military potential of individual countries or combinations of countries may adversely affect the national security of the United States.

"(6) Uncertainty of export control policy can curtail the efforts of American business to the detriment of the overall attempt to improve the trade balance of the United States.

"(7) Unreasonable restrictions on access to world supplies can cause worldwide political and economic instability, interfere with free international trade, and retard the growth and development of nations.

"(8) It is important that the administration of export controls imposed for national security purposes give special emphasis to the need to control exports of technology (and goods which contribute significantly to the transfer of such technology) which could make a significant contribution to the military potential of any country or combination of countries which would be detrimental to the national security of the United States.

"(9) Minimization of restrictions on exports of agricultural commodities and products is of critical importance to the maintenance of a sound agricultural sector, to achievement of a positive balance of payments, to reducing the level of Federal expenditures for agricultural support programs, and to United States cooperation in efforts to eliminate malnutrition and world hunger."

We urge this committee to implement significant legislation in support of these principles, and equally important, avoid legislation that results in protectionist measures as such action usually triggers retaliatory protectionist measures on the other side of the ocean.

We are presently in a dangerous drift toward global protectionism. It threatens the Western alliance in geopolitical terms and if the trend is not reversed it will spell long-term economic stagnation in both the Northern and Southern Hemispheres. It is imperative that we and our trading partners stop practicing sectoral protectionism and have a clear free trade policy.

Efforts should be made toward making bilateral trade agreements with all countries for reduction of tariffs on all commodities. An initial move to eliminating tariffs on all foodstuffs would be a great first step. It would induce other countries to follow in order to be competitive so that conceivably in five years time we could have a scattered common market reaching all over the world.

Secondly, elimination of sales taxes on exports currently levied at various stages in the manufacturing sequence would result in an end product price competitive with European products on the world market.

Thirdly, we urge that efforts be initiated to reduce non-tariff barriers with our allies and essential trading partners on a bilateral basis since the multilateral GATT negotiations have not been effective in keeping up with new trade barriers being imposed here and overseas.

A reduction of trade barriers will have a significant effect on the social aspects of society since it will reduce inflation and give the consumer a wider choice in the marketplace. It will have great economic effect by stimulating more trade which creates more employment both here in the United States and in each of our overseas trading partner's countries. Exports currently generate more jobs than those lost because of imports.

In fact a 10 to 11 percent increase in U.S. exports would eliminate half of our foreign trade deficit; it would reduce our domestic unemployment from 9.5 percent to 5 percent and the economic multiplier effect of this increase of $25 billion in production to meet the export demand would stimulate the entire economy so that the increased taxes would reduce our budget deficit by 18 to 20 percent

Another way of regarding the benefit to the domestic economy and our citizenry resulting from export expansion is the anti-inflationary effect that the growth of exports will have here.

An increase in exports of 10 percent in both manufactured products and services would result in a growth of 1.5 percent in our GNP and thus create the confidence needed to attract investment in new plants and equipment.

An increase of 10 percent in our exports would bring our exports share of our GNP up from 8 percent to 10 percent, which compared to most West European countries and Japan would still be only one-fifth of theirs.

A potential obstacle to trade expansion is the Transnational Business Codes being promoted in the United Nations. These favor the Less Developed Countries but have aggressive impact on both the industrialized world and the LDC's; a better approach would be implementation of reciprocal rights and obligations between the transnational corporation and the host country.

The erroneous argument that exporting causes domestic prices to rise can be easily disproven by showing that reduction in tariffs, both inbound and outbound will lower market prices, and increased two-way trade will give the American consumer lower prices. Comparative advantage in production will lower all market prices and reduce inflation.

New tariffs and quotas must be avoided for the benefit of both the United States consumer who should have a right of choice in the marketplace and for the benefit of Third World countries who need economic stimulus to export so they an afford to import new technology which in turn creates new U.S. export markets.

The darkest side of our export efforts has been the periodic embargoes that have been imposed. Just as with set aside programs in agriculture which never reduced production, embargoes have not had their intended effect. On the contrary embargoes have labeled the U.S. an unreliable trading partner. It is vital we assure our allies and our essential trading partners that they can count on the U.S. as a reliable supplier as long as we can count on them.

As the major supplier of foodstuffs on the world market, the United States now has the time and opportunity to establish trade agreements which should be linked to everyone's mutual interests. The U.S. production sector, U.S. political interests with NATO countries and other allies and geopolitical interest with countries who are essential trading partners who supply the twelve or more basic minierals which the U.S. needs to import to keep our industries going must have the prime consideration. Next should be the other countries ranked according to the best interest of the U.S., so that the world is on clear notice that the arbitary opposition in the UN and in international affairs will rank them accordingly—lower on the list.

The important aspect of this suggestion of a triage scale is not to threaten countries, but to assure those who are truly our friends, that they can count on the U.S. as a reliable supplier. The rest will know that we will trade with them subject to the limits of our supply of commodities.

The dichotomy of our farmers' quest for better market prices vs. the consumer's desire for lower food prices can best be met by elimination of tariffs and trade barriers on all foodstuffs on a bilateral basis country after country. The only way to increase market prices is to export surpluses thereby letting ordinary market forces come into play and giving farmers an equitable return on their investment and labor.

The dramatic increase in agricultural exports since 1972 has saved the farmer from bankruptcy. Increased productivity has enabled the family farm to keep up with inflation. Increased agriculture exports give the brightest opportunity for continuing vitality of American agribusiness and agriculture by providing a stable demand for commodities; while domestic agriculture without export marketing would create an unthinkable recession in the farming sector.

A cornerstone of our total agriculture policy should be: emphasis on agriculture research to enable the farmer to stay in business in spite of rising costs by increasing productivity to meet rising demands. Secondly, export credit programs should be expanded to include all 200 agriculture commodity groups so that each food group can be competitive with our overseas competitors in the world market.

The potential of doubling our agricultural exports again in the next five years will have significant impact on rural America. A potential for market expansion exists only if we export more and since only expanding markets attract investment capital it is vital that we continue our export market expansion.

The export expansion programs of both the Agriculture and Commerce Departments have been effective to a point, but only for certain commodity groups, and as a result 80 percent of our agriculture exports are handled by only 25 companies. Currently, 250 companies handle 80 percent of the commodities under that jurisdiction. The objective of export expansion to balance our foreign trade and to benefit the agricultural sector and meet the needs of a hungry world can best be met by expanding from 54 commodity groups and 68 countries into 200 commodity groups trading with 150 countries, thus arriving at a numerical expansion factor of 8 and a weighted expansion factor because of the size of the markets of approximately 4 times present volume.

To enable small and large sized companies to enter the export market ARDI has established TRADEXPO, a permanent, year-round international trade research and educational center designed to help all commodity groups and all basic human needs producers to enter the world market with minimum cost and risk. The international trade center is privately funded by the participating exporters, thus following the Administration's policy of having private enterprise do for itself rather than relying on government funds. This permanent year-round trade center will enable foreign buyers to find all agriculture and basic human needs, commodities and services available in a one-stop shopping center where they can learn the latest technology; see the latest applied technology in full scale model farm operatins of every type; and purchase what they need.

Foreign aid appropriation is unpopular here and is met with suspicion overseas, but when we install a turn-key poultry operation in a developing country with no political strings attached we create a market for our feed grains, our baby chicks or hatching eggs, our technology and equipment, our refrigeration units, transportation, egg cartons, etc., and thus everyone benefits.

The TRADEXPO international trade center is designed to assist our exporters where the services of the Foreign Agricultural Service of USDA and the Commerce Department leave off. We ask for the endorsement and cooperation of the relevant legislative bodies and executive departments so that we can best serve our common goals of export expansion to meet basic human needs overseas, and to improve the quality of life for our own agricultural and agribusiness sectors.

The lack of appropriate Export Financing has been the major impediment to export competitiveness in many markets. Many commodities and products sold on the world market do not differ significantly from those originating in other countries, and in many cases the sale or loss of export contract lingers on the terms of payment rather than quality or the country of origin.

The Japanese government finances 35 percent of their exports, the French 30 percent and the United States only 6 percent. These 6 percent are concentrated on a few of the agricultural commodities and on aircraft and a few other special groups by the EX-IM Bank. For most products and services, there are programs for financing on the books, but they are either not funded or not responsive to the real needs in the market place.

A responsive export financing program would permit small and medium size companies to enter the export arena on an even footing with the large companies who have established lines of credit and would allow all sizes of U.S. companies to compete with overseas producers of similar products.

The few write-offs that might occur would be covered many times over by reversing the lost production and lost tax revenue which now can only be estimated as a result of lost export sales.

We, therefore, urge passage of H.R. 3228 and S. 868 which would establish a special export financing fund.

A major step toward export equality for U.S. exporters in the world market would be expeditious passage of the Export Trading Company Act passed in the Senate as S. 734. The House has yet to act on this important measure which would clarify and facilitate cooperative export marketing as our overseas competitors do, but which was only vaguely permitted under the Webb-Pomerane Act.

In order for the United States to remain competitive, it will be incumbent upon us to increase investment in basic and applied research in those areas where we have Comparative Advantage in the world market. With more countries entering the world trading arena, it will be to the consumers advantage around the world to purchase from the country where they can obtain their desired level of quality at the best possible price; thus, it is important that this year's GATT negotiations stem the tide of non-tariff barriers which have emerged both here and overseas.

It is vital that the U.S. lead in this effort by example to maintain free trade inspite of the LDC's efforts for protectionism.

Since the Keynesians have left the White House, we have an opportunity to let the economy balance itself. History has proven Adam Smith right that the economy will adjust itself to reach equilibrium when acted upon by exogenous factors and Keynes and his disciples have shown that too much governmental interference always causes a "tilt" in the system or a recession.

It seems inexcusable to artifically "cool" the economy by tightening credit when other options exist. Thus, it seems inexcusable that a citizen, who pays his taxes, serves in the armed forces, and otherwise is an asset to his community, can have his job legislated away or his small business go bankrupt all in the interest of a tight credit policy by the Federal Reserve Board or the Administration.

Past Administrations have covered their budget deficits mostly by printing more money. Recently the Administrations have covered their budget deficits mostly by borrowing in the market. Since either method is inflationary, we suggest that the printing press be used in combination with borrowing on the market partly to dispel the anticipation of long term high competitions for funds and therefore high interest rates. But most importantly, as an effective tool to gently adjust the money supply without the damaging jolts which have been experienced recently.

In this way our economic model shows that the Administration's program of tax reduction and increased defense can be made to work and a balanced budget can be achieved within 4 to 6 years provided that we expand our exports and reduce the cost of credit by not covering the national budget deficit with what should be our investment capital.

Chairman GIBBONS. Thank you, sir. I realize how important this matter of financing is. To go back to the testimony of a previous witness, my friend from Boeing, in his statement on page 8, had a breakdown of the typical distribution of aircraft life cycle, cash, direct, operating costs. In that case, 9 percent of the cost is annual costs. The direct operating cost is just interest alone on the debt of purchasing the aircraft.

It is nearly as big as the cost of the aircraft being depreciated. It is probably larger than any one single item in the whole equation except the price of fuel.

Mr. NELSEN. The financing——

Chairman GIBBONS. Financing is important, but I think because of the unique nature of financing, it is something we have to reach an international agreement on because I do not know how we can ever operate on anything less than that. It is certainly very important in your area where, if you are selling rice and it is the same quality and the same grade of rice, price is important, but financing is and delivery is what is going to turn the table on the group who purchases. I guess it is the same for wheat and other products.

Mr. NELSEN. Any commodity.

Chairman GIBBONS. It is obvious that we must get out of that. You mentioned in your statement that you had some concern about what was happening in the U.N. about the transnational business code. Can you elaborate on that?

Mr. NELSEN. That is an outgrowth of the legislation that came out both on international bribery and on the international conduct of business. It applies to the U.S. companies. It does not apply to all its competitors. It puts us at a great international disadvantage.

The definition, in many cases, of what is a bribe and what is a commission and what is a finder's fee is very vague. In certain parts of the world it is assumed that you have to pay a finder's fee.

I was in the business of exporting before I got into running a trade association. My concern when I was overseas was finding out how much, not whether or not. It was assumed you were going to have to pay a finder's fee somewhere, and it turned out that many companies are deathly afraid of getting caught in a trap there.

The large companies have legal staffs that keep on top of all the laws, and regulations, the precedents, and so forth. And the small company is just frightened away from the market because they do not have the legal backup for that. And so it comes back to why there are only 275 companies exporting 80 percent of our total exports of the United States? That is because it is too difficult for some of the small companies to get involved.

This is one aspect. Actually, credit is the biggest area when large companies are asked to bid on something. They have a standing line of credit. A small company has to go out and establish a line of credit. That can take weeks before the banks say, OK, we will cover you on this proposal you are making to Nigeria. Excuse me for digressing.

That United Nations question you asked about is pending now. I am not really sure when it is coming up, but it is an important aspect for the whole export sector, especially the small- and medium-size companies.

Chairman **Gibbons**. As far as I know, you are the first witness we have had in this oversight hearing that has mentioned that. I knew that the European Community had one on the books or one that they were working on. And, you know, at first blush, some kind of rules about business practices do not sound bad as long as they are reasonable. But you think these are aimed particularly at us?

Mr. **Nelsen**. They are, because the OECD countries had a code of ethics that was fairly well publicized. The one in the United Nations is being promoted by the southern part of the north-south group, which is a group of 77.

Chairman **Gibbons**. The OPEC group?

Mr. **Nelsen**. No; not OPEC, the nonalined LDC's. They are advocating a 1-percent tax be set aside on all exports because of all the wrongs that have been done to them in the past, that whole scenario.

Chairman **Gibbons**. The harm that has been done to them in the past, whether real or imagined.

Mr. **Nelsen**. It is just a bad can of worms to open up because there could be no end to it if we start recognizing that. The best way we can help the Third World countries is by joint venture projects by helping them on a project-by-project basis to develop their industry, and in the long term they will become better trading partners of the United States and they will become active members of the world market rather than creating a subsidy for them or a welfare system, which is really what it amounts to.

Mr. **Conable**. Mr. Chairman.

Chairman **Gibbons**. Mr. Conable.

Mr. **Conable**. Tell me, Dr. Nelsen, from your point of view, how serious is the development of European grain surpluses, which will now perhaps under a common export policy be subsidized into the world market, in terms of the efficiency of that world market and in terms of its impact on American trade generally and agricultural produce?

Mr. **Nelsen**. It is a cyclical market. The Europeans have as much clout collectively as we have.

Mr. **Conable**. Have as much what?

Mr. **Nelsen**. Clout, force in the market as we have. They have been able to effectively cut us out of the milk export market, for example. If an order comes up for dry milk somewhere in the world, we know that a European country is going to get it because they have literally mountains of it laying in Holland just like we have cheese sitting out in Wisconsin that we are not distributing.

Mr. **Conable**. But they are also distributing surpluses of wheat by virtue of the very high price at which they peg their grain.

Mr. **Nelsen**. Right.

Mr. **Conable**. They also do not use it as feed, because it is too expensive. They use our soybean meal instead and use that as a justification to talk about substitution factor, for instance. They are generating unnecessary and artificial surpluses as a result of this very high price. The European agriculture is efficient and does not need subsidization, but they are going to get rid of it only by subsidizing it in the world market. They seem to do this whatever it costs, using their value-added tax proceeds in the European Community to do it, in order not to carry over any surpluses from one year to the next.

It seems to me that things are just generally going from bad to worse in terms of its impact on American agricultural trade.

Mr. **Nelsen**. Absolutely.

Mr. **Conable**. Is that an accurate statement of what is happening?

Mr. **Nelsen**. Yes; I think you have to recognize some of the historic background of it. The European countries, being very small and having fought with each other for hundreds and hundreds of years, have always felt the need much more than we have for self-sufficiency. Therefore, they will always put their farmers in a much higher standard or a much higher category of appreciation than we have ours. They feel that food, in time of emergency, is essential.

Mr. **Conable**. They also have a much larger farm population relative to the total population, and they tend to be somewhat less stable governments than we, and therefore they want to protect themselves by not offending their farmer class.

Mr. **Nelsen**. I think the present surplus is a temporary phenomenon, because in the long run their cost of production is higher than ours.

Mr. **Conable**. Terribly expensive?

Mr. **Nelsen**. Yes; absolutely.

Mr. **Conable**. So you do not expect that to be a serious problem in terms of our future agricultural trade?

Mr. **Nelsen**. No; absolutely not, because it was the same with the Russian grain embargo, when we did not put that many tons of grain on the table, they got it from someone else. And the balance in the world supply-demand market stayed almost the same.

I think the Europeans are going to find out that it is not in their long-term interests to maintain those surpluses.

Mr. CONABLE. Let me ask you something. We are trying to constantly expand our trade with Japan, particularly in the agricultural area. I would imagine if I were Japanese, I would worry about having to eat bark again if the United States, were to cut off my food supply.

I think that we ought to sit down with the Japanese and perhaps make some kind of long-range commitment, mutual commitment, with them about food supplies. Do you have any views on that?

Mr. NELSEN. They have high restrictions. We know that meat costs between $15 and $18 a pound in Japan. I think the only leverage we would have is that we demand they increase their funding for defense.

Mr. CONABLE. What can we really do with them on rice and meat and other staples in their diet if one concern in their mind and certainly one concern that is politically defensible—is their feeling that they cannot be dependent upon American food supplies because they are concerned with how reliable a supplier the United States will be in times of emergency.

After all, we did cut off their soybeans when the price of soybeans went up in this market. And there was not even anything like——

Mr. NELSEN. It is not well known.

Mr. CONABLE [continuing]. Anything like a food crisis in this country. It is just a price crisis we have. If we cut off their food supply, how can we expect them to relinquish such things as rice acreage, and beef production, and things of that sort?

Mr. NELSEN. Japan is a major supplier in the world market of rice. They grow some themselves and they get a lot from Thailand.

Mr. CONABLE. Yes.

Mr. NELSEN. It is not very well known that Japan is our biggest customer for agricultural exports.

Mr. CONABLE. I know they are. I understand that.

Mr. NELSEN. When you read it in the paper, it sounds like they are just letting them in with an eyedropper, but actually they are importing tons and tons.

Mr. CONABLE. I understand they are. They are big consumers of American products, food products.

But do we need to do anything else in that market as far as selling them more? We could sell them a great deal more.

Mr. NELSEN. We could sell them a lot more. It is a political issue. I know that Bill Brock has been working hard on breaking down some of those barriers. I think the worst thing we can do is put up barriers on this side, because barriers beget barriers. Our whole GATT system is shot because of these indirect trade barriers that are being put up at a quicker rate——

Mr. CONABLE. Considering their already heavy dependence on us for food supplies, and considering the fact that we are pressuring them more to absorb more American food and to, in effect, withdraw some of their acreage, very expensive acreage and very expensive farming practices, from production, would it not be wise for us to say, well, we are going to cut ourselves in the same place they are? Suppose we were just living on a daily market basis. Should we not be willing to make some longer-term commitment to them, some standbys in cases of emergency, if we expect a larger share of their food market?

Mr. NELSEN. Are you talking about an agreement similar to what we have with Russia?

Mr. CONABLE. A food agreement.

Mr. NELSEN. It would be very helpful. I think the worst thing we could do is threaten them, because I believe Japan could buy all the food they wanted somewhere else if we made that a national policy.

This comes down to, and I mention it in my paper here, GATT has not worked. One of the best ways to make it work is to make bilateral agreements between any two countries anywhere, any two by two, to lowering all trade barriers, on food in particular, to begin with, and eventually in all products. That would give each, and the next, and the next countries a trade advantage that would force the others to drop their trade barriers.

It sounds a little simplistic, and if you want me to give more facts, I can. But I did summarize it in the paper.

In other words, we have import duties on things that we do not produce or grow in this country, coffee beans, bananas, Danish cheese—well, maybe cheese is a bad example—but certainly on things that are not grown here at all. It would lower our cost of consumption to the consumer here, our inflation rate would go down if we reduced import duties.

If on a country-by-country basis we would say, we will lower all our barriers if you will lower all your barriers, it would force the other countries to follow through.

Now, this is a big step, and it is not something that would come easily. But it would be one way to solve the problem you are talking about.

Mr. CONABLE. You are talking about a form of reciprocity.

Mr. NELSEN. Reciprocity implies a particular commodity. I am talking about across the board. I am talking about all food commodities. That is the least controversial, from a humanitarian point of view. In some countries it is highly political because they want to protect their farmers. But again, farmers in most countries could specialize in those commodities where they have an economic advantage rather than to try and grow everything for self-sufficiency.

Chairman GIBBONS. I thank you for coming here and spending your time with us. It has been very useful and very productive.

Mr. NELSEN. I appreciate the opportunity.

Chairman GIBBONS. Our concluding witness for today is Mr. Malcolm E. O'Hagan. Boy, what a day for an Irishman. He looks in pretty good shape, though.

I assume you are an Irishman?

Mr. O'HAGAN. That is right, Mr. Chairman.

Chairman GIBBONS. Or were, at one time. I will put it that way.

Mr. O'Hagan is president of the Valve Manufacturers Association. We are glad to have you here.

STATEMENT OF MALCOLM E. O'HAGAN, PRESIDENT, VALVE MANUFACTURERS ASSOCIATION

Mr. O'HAGAN. Thank you.

Mr. Chairman, my name is Malcolm O'Hagan, and as you indicated I am president of the Valve Manufacturers Association. VMA represents 81 U.S. manufacturers whose sales account for approximately 80 percent of the $3 billion U.S. industrial valve industry. Our industry is heavily involved in and impacted by international trade, and we appreciate the opportunity to testify before your committee on U.S. trade policy.

First a few words about our industry and its products. Valves are an essential part of every flow control system, and perhaps it is because they are so widely used that there is little public awareness of their importance to the economy.

There are literally thousands of variations of these valves which are manufactured for use both in noncritical flow control systems such as water and fuel distribution, and in supercritical applications such as liquid sodium heat exchangers used in nuclear power reactors.

The U.S. valve industry also supplies several key defense and defense-related programs with essential components for such important activities as shipbuilding, fuel production, chemical processing, power generation, and missile programs. Moreover, the energy producing industries of the United States are heavily dependent upon the U.S. valve industry, accounting for about half of the domestic industry's total sales.

Indeed, valves are absolutely essential components for power generation, coal gasification, and oil and gas production and refining. In the years ahead the U.S. energy industries will need larger numbers of more complex valves to satisfy the steadily growing demand for natural petroleum products and synfuels to achieve energy independence for the United States.

Turning now to U.S. trade policy, I am sure, Mr. Chairman, that most if not all of what I have to say this afternoon will sound only too familiar. But at least it will reinforce the fact that here is yet another critical U.S. industry that is suffering severe adverse consequences of idealistic and unrealistic U.S. trade policy.

Our industry is heavily involved in international trade and our position is based on extensive experience in world markets. While specific figures are not available, it is estimated that U.S. companies through their domestic and international operations account for about 40 percent of the world demand for industrial valves.

A recent survey indicated that approximately 50 percent of our members have foreign manufacturing operations. A similar number are involved in international joint ventures and about 60 percent have foreign licensing agreements in a variety of countries. Our members have been heavily involved in exporting and the U.S. valve industry is proud of the fact that it has made a positive contribution over the years to the U.S. trade balance.

However, Mr. Chairman, in recent years our position in world markets, and especially our domestic market, have begun to erode as a direct consequence of trade policy and foreign trade practices. While the United States has been opening its markets to foreign products and the U.S. Government has been making it more difficult for U.S. companies to engage in international trade, other countries have been erecting barriers to free trade, and our foreign competitors have enjoyed the support and cooperation of their governments in promoting their exports.

Prior to 1973, valve imports were not at a significant level in the United States. However, from 1973 to 1978 we saw a four-fold expansion. This trend has continued in recent years with imports increasing by 102 percent from 1978 through 1981. During this same period, exports increased by only 53 percent, so the trade balance that we once enjoyed is being seriously eroded.

In certain valve categories the figures are even more disturbing. Take hand-operated iron and steel valves for example: Imports in this category increased by 150 percent from 1978 to 1981. In the case of iron and steel gate valves, imports in 1981 accounted for at least 33 percent of domestic consumption. And in the more popular size categories, the figure is estimated to be in excess of 50 percent.

More alarming is the negative trend line which is creating severe economic problems for U.S. manufacturers. Just recently the Wall Street Journal attributed the closing of a valve manufacturing plant largely to imports. Japan accounts for 21 percent of valve imports, Canada for 13 percent, the United Kingdom for 12 percent, and France 10 percent.

While some of the blame for the dramatic increase in imports and the slackening of exports can be attributed to the significant swing in foreign exchange rates, the weakening of the world and U.S. economies, and the stifling effect of exhorbitant U.S. interest rates on productivity, inequitable trade practices must share the blame.

U.S. manufacturers have been handicapped by an unfair tax structure, the restrictive Foreign Corrupt Practices Act, lack of export financing and lack of a genuine Government commitment to export promotion. Coupled with these are the restrictions which other countries have imposed and the export incentives which they have provided to their own companies.

For example, as I indicated earlier, approximately 50 percent of valve sales are to the energy-related industries. We are all aware of the critical importance of export financing for the large construction projects to build powerplants, refineries, and processing facilities. Our members have lost significant orders strictly due to the lack of competitive export financing from our Eximbank.

In testimony before this committee in 1979, we expressed our serious concerns and reservations about the provisions of the multilateral trade agreements. As we indicated then, it is difficult to discern with any accuracy the global gains derived from efforts to liberalize trade. The task of determining advantages or disadvantages is not made any easier when one attempts to understand with precision who gains and who loses as a result of trade liberalization within a national economy.

The reason for this difficulty is simple: The gains and the losses that result from liberal trade are not evenly distributed within the economy. For example, while consumers may, over the short run, gain from unrestrained trade, some domestic businesses will suffer reduced production and indeed may be forced to close. A business closing of course hurts workers and imposes welfare costs on local governments. In short, what appears as a gain could have a significant cost attached to it.

The industries most apt to suffer from trade liberalization are those that are labor intensive or those that utilize simple, well-known technologies. Since significant segments of the valve industry bear these characteristics, we predicted that the trade agreements could result in harm to our industry and its workers.

Unfortunately, these predictions are turning out to be true. For a particular American industry to benefit from liberalized trade it is imperative that the scales balance, and that the concessions made on the part of the United States be matched by those of other countries. Once this is accomplished, domestic industries with sophisticated or advanced technology will reap the benefits of greater access to foreign markets, since the products of these industries are the items in greatest demand abroad. Since it is the industries with new technologies that will gain through trade liberalization, the American workers that will suffer most from freer trade are the semiskilled workers. With these workers engaged in industrial activities located in urban centers of the North and East, these geographic areas will suffer from trade liberalization. Insofar as semiskilled workers occupy lower-income positions in our economy, the low-income workers and their families will bear the major share of the adjustment that is sure to follow trade liberalization. It is these workers incidentally who are always less mobile and harder to retrain for work in other parts of the economy.

While consumers may enjoy some short gains from trade liberalizations, there may be significant costs paid by certain industries, certain workers, and certain sections of the country. Segments of the U.S. valve industry have been braced for these types of adjustments and, to an extent, have had to cope with them already.

However, our ability to export the more highly engineered, sophisticated valve products have been severely impeded by the inequitable trade restrictions imposed by certain other countries. In addition to high import duties imposed by certain countries—most notably Canada and South Africa—U.S. manufacturers find that it is virtually impossible to export to Mexico and Brazil. Foreign direct investment in many countries is limited. Restrictions exist on return of invested capital and repatriation of profits to the United States. And there is unsatisfactory patent protection. Nontariff trade barriers such as those employed by Japan impose a prohibitive penalty and many countries require domestic content in valve products.

In summation, Mr. Chairman, the Valve Manufacturers Association supports fair trade. Our members are not afraid to compete on an equitable basis with foreign manufacturers. They are not afraid to venture abroad in promoting U.S. products.

In fact the reason why I am here alone today is that members of our International Trade Committee who would have joined me are in China, Mexico, and Australia. Next month we will be sponsoring a special workshop to help our members further expand their trade in the Middle East and in Southeast Asia.

We believe that the best defense is a strong offense, and our members are on the offensive. However, we need a U.S. trade policy that is supportive of our efforts, not one that works at odds with us. While the ideal of free trade is laudable and one that we should continue to work toward, in the interim we must protect our flanks by taking a pragmatic approach.

Accordingly, Mr. Chairman:

VMA urges the continuance of the DISC program.

VMA advocates expanded Eximbank funding.

VMA supports repeal, or at least amendment, of the Foreign Corrupt Practices Act.

Finally, VMA advocates that the scheduled reduction in import tariffs under the multilateral trade agreements be deferred at least 2 years, or until such time as those countries with which we trade provide U.S. manufacturers with equal access to their markets.

Thank you, Mr. Chairman, for this opportunity to appear before your committee. If you have any questions, I would be glad to try and answer them myself, or to secure answers for you.

Chairman GIBBONS. Well, most of your recommendations I concur in, and I think they are very well founded. I wonder, though, would you like to document a little more about that last one you had about suspending, what was it there?

Mr. O'HAGAN. The reduction of import tariffs. The tariffs on valves are scheduled to be reduced significantly over the next few years. It is the feeling of our members that we are not seeing reciprocal action on the part of many of the countries to which we are trying to export our more sophisticated valve products.

We feel there should be reciprocity, that we should be getting equal treatment from the countries that we are trying to export to.

Chairman GIBBONS. Would you remind me a little more specifically who is not living up to the agreement?

Mr. O'HAGAN. The countries are living up to the agreements with respect to import tariffs. But what we are encountering are other nontariff barriers, referred to earlier here, particularly in Japan.

Many of our companies find it almost impossible to export to Japan. As a consequence, some of them have tried to establish joint ventures or manufacturing operations in Japan to try and get around the problems involved in exporting to Japan.

Increasingly, we are seeing valve companies going to offshore production, going to joint ventures in other countries, rather than being able to maintain their operations here and export. The consequences of this, of course, are adverse not only on the companies but on the job situation within the industry.

Chairman GIBBONS. Could you tell me with any specificity what the Japanese are doing in not living up to the agreement?

Mr. O'HAGAN. One of the specific problems that our manufacturers are encountering is in the area of testing and distribution. I am not familiar, Mr. Chairman, with the specific details there, but I would be glad to try to get some specifics for you.

Chairman GIBBONS. Well, that would be helpful if you would. If you get them anytime soon, we will place them in the record. If you do not, I would like to have them for my own personal files, if not the committee files, because we are constantly talking to the Japanese, and it is always helpful if we can talk in terms of specific problems. So I would welcome that type of material.

Let me ask you, there are provisions in our trade laws and there are provisions under GATT where if we fail to get what we bargain for we can go back and open up the matter or change the matter. Have you explored any of these?

Mr. O'HAGAN. Yes, we have, Mr. Chairman. In 1979 we petitioned for countervailing duties and went through considerable effort, but when the law changed requiring that we show significant damage to the industry——

Chairman GIBBONS. Not significant damage, injury.

Mr. O'HAGAN. Injury. It was decided not to pursue it at that time. We are reconsidering it again at this point, because I am sorry to say that conditions have deteriorated fairly significantly from that time.

Chairman GIBBONS. Well, the American dollar, of course, is in a very bad position for exporters. Have you attempted to measure how much of it is dollar value related?

Mr. O'HAGAN. There is no question, Mr. Chairman, that some of it is related to the strength of the dollar. I would also have to say that some of the problems are related to our own domestic economy, the weak economy we have here. I think it is imperative that every effort be made to strengthen our domestic economy to give us a solid base from which we can operate in the world market.

Chairman GIBBONS. I believe you were in the room a while ago when the gentleman from Boeing testified that they, in effect, said that they were a labor-intensive operation and were able to compete. I think they said their biggest problem was competitive financing. Is that your problem, or is it the fact that your technology is not that advanced? He said that the technology really was not that important in airplane development.

Mr. O'HAGAN. Our technology is a mature technology. It is a simple technology for a fairly significant portion of the industry. However, other segments of the industry are fairly advanced in their technology. I think you will find that most of the exports and most of the international trade conducted by U.S. valve manufacturers is of the more sophisticated product.

However, many companies have lost significant orders due to the lack of export financing; for example, in Korea on the nuclear plants.

Chairman GIBBONS. I would imagine those would have to be pretty sophisticated valves. Who did we lose that business to?

Mr. O'HAGAN. To the French.

Chairman GIBBONS. To the French. Do you know why? Could you attribute some reason for our losing it to the French?

Mr. O'HAGAN. It is my understanding it was primarily due to the fact that they had a favorable export financing package which was not available to the U.S. companies.

Chairman GIBBONS. OK. Thank you, sir. I look forward to receiving some materials from you on Japan. Thank you very much.

Mr. O'HAGAN. Thank you, Mr. Chairman.

Chairman GIBBONS. This concludes the Trade Subcommittee trade policy oversight hearings. There have been many suggestions and proposals made by our witnesses during these hearings. The subcommittee will want to study them and review them and take them up with the administration and perhaps take up a lot more with the private sector of our economy.

The hearing record will remain open until the close of business on March 25 for inclusion of additional materials and statements.

We appreciate the cooperation of all the witnesses and all the staff that have been so patient in preparing all of this material. It has been a very interesting set of hearings for me, and I hope that we can get some positive action out of what has taken place here.

Thank you very much.

[Whereupon, at 3:40 p.m., the hearing was adjourned.]

[The following was submitted for the record:]

STATEMENT OF AMERICAN ASSOCIATION OF EXPORTERS AND IMPORTERS

Mr. Chairman and members of the subcommittee, the American Association of Exporters and Importers, formerly the American Importers Association, represents 1,400 U.S. company-members engaged in the export, import and distribution of goods throughout the world. AAEI is the only national association comprehensively representing U.S. business interests in the international trade community before the Federal Government.

The multitude of products sold by AAEI member companies cover a broad range from textiles and apparel, chemicals, machinery, electronics, footwear and food to automobiles, antiques, toys, wines and specialty items. In addition, many organizations serving the trade community—customs brokers, freight forwarders, banks, attorneys and insurance firms—are active members of AAEI.

Much of the testimony before this Subcommittee in these oversight hearings has focused on emerging trade problems such as export financing practices of foreign competitors and barriers to trade in services and investment. These issues are of great interest to AAEI's members. However, we wish to discuss a number of other disincentives to exporting which are perhaps less glamorous but vitally important to current and potential U.S. exporters.

This Subcommittee has known our organization for many years as the American Importers Association. We believe we have served a unique function as an information bridge between the importing business community and the Government. We have worked to increase the flow of information and to promote understanding and maximum cooperation. We intend to continue this function undiminished.

In the last few years, however, our members' increasing export business has led them to ask the Association to provide comparable service for exporters. As this Congress and the Administration are aware, many U.S. manufacturers, large and small, would be strong competitors in foreign markets, yet do not export to their full potential, despite our Government's efforts. AAEI hopes to serve both government and business by facilitating the flow of information on the day to day, nuts and bolts problems of exporters. Businessmen cannot expect the government assistance on such "micro-problems" unless the Government is advised of what help is needed. Individual businesses aare often reluctant to begin a dialogue or may even believe that the Government is not interested.

We think that AAEI can increase business awareness of the Government's unique means to overcome the obstacles that prevent American companies from making export sales.

I. TACTICAL BARRIERS TO EXPORTS

Over the last decade the United States has led the way in shaping a more open world trading system. We have been remarkably successful. Other nations, particularly Japan, have concentrated on making full use of the openness of that system. As we all know, they too have been remarkably successful. It is time for the U.S. to address that anomaly. The United States should encourage the Japanese and other major trading nations—both developed and developing—to share the burdens of leadership in implementing a system of world trade governed by law. At the same time, the United States should concentrate on assisting U.S. business to make full use of that system.

The United States is demonstrating an increased commitment to remove broad, policy-level barriers to exporting. These might be termed "strategic" barriers when compared to the everyday "tactical" barriers most exporters also face. AAEI believes that business and government must begin to focus on these everyday, "nuts and bolts" barriers as well.

We might begin by: "What keeps a potential U.S. exporter from going out next week and making an export sale?" Individual companies are likely to encounter at least four types of obstacles: 1) market information, 2) financing, 3) market access in foreign countries, and 4) competitiveness.

A. Market data

In response to a detailed questionnaire, AAEI members highlighted their need in locating potential buyers in other countries. Those requests ranged from merely obtaining advice on the do's and don'ts of selling in other cultures, to locating and indentifying potential customers abroad. The Foreign Commercial Service, the U.S. Commercial Service, and the other marketing and data services of the Commerce Department are excellent mechanisms for gathering and disseminating such information. Some significant problems remain, however, in the timeliness and the quality of their responses to inquiries. Part of the problem is that government officials often lack the experience and knowledge needed to give advise about exploiting foreign markets. Export trading companies will spread information only to those ready to commit a product line. Other exporters' needs for more diverse information will continue. We will do our best to complement Commerce's service on the business side.

For Commerce's services to be successful, business must perceive the Government as a partner will common interests. Yet recent Commerce Department action provides an example of how the Government can unwittingly handicap its own efforts to foster that perception.

In a notice appearing in the Federal Register of June 18, 1981, (46 Fed. Reg. 31,911), the Compliance Division of the Office of Export Administration, International Trade Administration, delegated to the District Directors of the U.S. Commercial Service authority to serve subpoenas and to require business to permit the inspection of books, records and other property. The Directors' role as enforcement officers compromises their positions as advisors to business. A company is unlikely to confide business information to an office authorized to use that information against it. If the Compliance Division is without sufficient resources to undertake such enforcement on its own, it has alternatives outside the U.S. Commercial Service, such as the Customs Service.

We also wish to express our concern over reports that the Office of Management and Budget is considering the elimination of several Commerce Department export promotion offices, including the Foreign Commercial Service. AAEI supports budget reductions which eliminate nonproductive government functions. These Commerce programs, on the other hand, stimulate the domestic economy through export sales. A period of economic stagnation is a poor time to eliminate them.

B. Export financing

Small and medium size businesses seeking to begin or intensify exporting efforts often need new sources of capital. The Ex-Im Bank is not always a practical alternative. The Foreign Credit Insurance Association, which insures receivables for the export so that banks can discount the accounts for the exporter, has only recently begun to service small or beginning exporters. Further, financing problems differ dramatically from industry to industry. Through the U.S. banking and freight forwarding industries increasingly have the sophistication and capacity to finance exporters, creative programs are still needed to accommodate the full range of requirements, from those of sophisticated exporters to the simpler needs of small exporters.

We also note our agreement on the broader issue that Ex-Im Bank financing rates must be competitive with the export credit rates available to foreign suppliers. If we cannot negotiate away foreign credit subsidies, we must nullify their effect by matching them.

C. Market access in foreign countries

This category encompasses a broad range of obstacles to export sales. Exchange rates fluctuations, different tax structures, international payment procedures, foreign technical specifications, special overseas shipping requirements, servicing problems, or simply a foreign language and culture all may deter potential exporters from pursuing a foreign sale. While freight forwarders, banks, and other service companies can help, a small or medium size producer may conclude that the sale does not justify the additional cost and effort of his education.

If a company penetrates these barriers, it may then encounter government-imposed trace barriers. The codes agreed to during the Multilateral Trade Negotiations are a major step toward a system for dismantling these barriers. However, to implement the codes, particularly at low levels of foreign government trade administration, the U.S. Government must have the help of the international trade community. These obstacles must be brought to the Government's attention especially by small and medium size companies, which may be forced to terminate their sales efforts by code-violating foreign regulations (whereas a large company could work around them). AAEI plans to be very active in working with the Government to reduce these obstacles.

Exporters may encounter persistent problems with foreign private or governmental entities which do not reach the level of violations of law, yet still hinder trade. Such problems include unnecessary or confusing documents, regulation of carriers and payment procedures, or marking and labeling requirements. Here the Government can help through trade facilitation committees, such as the U.S.-Japan trade facilitation committee, composed of officials from the countries involved.

Finally, another multilateral negotiation will be required to achieve meaningful liberalization of some market access problems. AAEI fully supports the Government's efforts to establish negotiations on trade in services. We also urge the Government to press strongly for agreement on a GATT counterfeiting code.

D. Competitiveness

This Subcommittee and numerous agencies are well aware of the need to help improve the competitiveness of potential exporters. We would encourage an even stronger effort toward this end. Management of the domestic economy profoundly affects the ability of American companies to compete against foreign competition. Two of the many specific ways the Government can promote U.S. competitiveness in world markets are to stimulate research and development and to establish depreciation schedules that are more internationally competitive.

Small business may need special assistance, and, again, closer government/industry contact should help produce solutions. We must address both the broad issues and the minor ones that hinder small business' export efforts.

Of course, the government alone cannot make potential exporters competitive; each company must examine its own position. Often much can be achieved simply by establishing a business strategy aimed at obtaining an international market share large enough to ensure economies of scale and thus increased competitive strength. To be competitive abroad, a company cannot view the United States as its primary market and exporting as a mere outlet for surplus production. It must plan products and product designs which account for local customs, preferences, and competition. The additional capital requirements of international transactions should be taken into account at the earliest planning stages. Carefully structured overseas sales and distribution networks, however narrow the planned market penetration may be, must replace ad hoc selling arrangements. At the same time, an exporter should not neglect the sales and production skills which made it successful domestically simply because the market is foreign. The assumption that markets are segregable by national location is increasingly problematic.

II. THE UNITY OF EXPORT AND IMPORT POLICY

AAEI took on its new export function in part because we found it increasingly difficult to draw a line between import and export issues. For several years we have urged trade policymakers to consider exports and imports as parts of a whole and to recognize that because of the interrelationships of trade and its regulation, imports and exports cannot be dealt with in isolation. We will examine below one example—the harm done to the competitiveness of U.S. steel-using exporters by the protection given to the U.S. steel industry. Two other current issues forcefully underscore this general proposition: U.S. implementation of the new GATT Valuation Code and the development of an internationally uniform tariff classification code (the Harmonized System).

A. Valuation code implementation

To date we have addressed this Code as it affects U.S. importers. For the most part we find it to be a significant advance. The Customs Service has enthusiastically and faithfully implemented it, and the transition has been relatively smooth. On one issue, however, the dutiability of inland freight and other ancillary charges paid to the seller for services by third parties, we believe the Customs Service has misinterpreted the law. We raise the matter here to demonstrate that a regulation on imports can affect the competitiveness of U.S. exports.

The Customs Service has ruled that any payment made to the seller is includable in dutiable value even if the payment was for collateral services which Customs would not include if it were made to a third party for the same service in the same transaction. Examples of such payments include interest charges, freight charges from the manufacturing plant to the port of exportation when the goods are sold ex-factory, and the cost of quota permits purchased from a third party. If the seller prepays or assumes these expenses and is reimbursed by the buyer, Customs holds them dutiable, even if invoiced separately.

Customs' position misinterprets the statute which says, "The transaction value of imported merchandise is *the price* actually paid or payable *for the merchandise* . . ." [Emphasis added.] Since these charges are for collateral services, not for the merchandise, they are not properly part of dutiable value so long as they are itemized separately from the price of the goods.

This policy is likely to affect adversely the treatment of U.S. exports by other nations. Precisely because of U.S. leadership in implementing the Code, other nations treat U.S. interpretation as a model. As more nations adopt this particular policy, more U.S. exporters will be competivitely disadvantaged. Even if the courts reverse Customs' position, the result will come too late since this policy will by then be firmly entrenched worldwide, raising the price of U.S. exports as they compete with goods produced and priced in the foreign-market country.

The AAEI supports authorizing funds for the U.S. Customs Service to train and assist other national customs authorities in their implementation of the Valuation Code. In virtually all areas except the one criticized above, Customs has implemented both the letter and the spirit of the Code, and it would be a great service to our nation's export interests if customs could promote its intrpretations on a uniform, worldwide basis.

B. Harmonized commodity description and coding system

For many years AAEI has been following the development of U.S. policy regarding the adoption of a multinational system for the classification of merchandise for customs and other purposes. In 1974, AAEI agreed to support the concept that all trading nations should adopt such a system. In 1977 in testimony before this Subcommittee AAEI urged the Congress to provide funding to assure complete U.S. participation in the developmental process. We are gratified that to date the United States has been a full and active partner in the development of the Harmonized Commodity Description and Coding System (HS).

We are concerned, however, that progress toward the adoption of the HS has developed in unforseen ways that, if not corrected, could weaken support for enactment of the system in the United States.

First, we strongly believe that a new system which uses more than eight digits for both duty and statistical purposes will create an enormous burden for both the Bureau of the Census and the business community from the standpoints of cost, efficiency and paperwork and provide an unnecessarily high level of transparency.

Second, because the interplay of the chapters cannot be seen unless the complete publication is available, it is extremely difficult at this time to effectively analyze and comprehend some of the classification effects in chapters already agreed upon by the Customs Cooperation Council and published for comment by the U.S. International Trade Commission.

Third, until the nomenclature is correlated fully with the Tariff Schedules of the United States, some individual importers and exporters will not be able to assess either the impact of adoption on their business or the trade neutrality of the HS. This process has begun, but a complete correlation is not expected in full until 1983.

These last two elements have combined to minimize meaningful comment on many of the chapters published thus far.

Finally, and perhaps most important, there has been no public determination as to who will have the ultimate authority to interpret the new tariff schedules.

The U.S. trade community is becoming seriously concerned over these developments, and interest is growing in extending the schedule for the next phases toward adoption. Statutory enactment of a tariff classification system which has not been studied adequately by importers and exporters will inevitably require extensive correction and amendment, despite the very best efforts of the responsible agencies.

The Harmonized System is as important to U.S. exporters as to U.S. importers. It should be enacted only after the most detailed scrutiny by the trade community. The ITC has taken great pains to obtain this assistance, but circumstances have conspired against it. AAEI, too, has been publicizing opportunities to comment and has had an active HS Committee. The unexpected problems described above, however, have overcome all our good intentions. We are meeting with the agencies involved to discuss these problems in more detail.

III. UNITED STATES IMPORT POLICY

A. The effect of import policies on exports and the domestic economy

As the only organization of national scope representing importers, AAEI has seen firsthand the relationship between U.S. trade policies toward imports and expanded U.S. opportunities for exports of goods and services. Politically, U.S. import policy is viewed by our trading partners as a test of the United States' commitment to liberal trade principles for the benefit of all countries, not just as an avenue to gain unilateral advantage. Economically, U.S. import policy critically affects the ability of our trading partners to absorb and pay for additional U.S. goods and services. U.S. efforts to liberalize and expand trade can succeed only through a trade policy consistent with these political and economic relationships.

Protectionist arguments often focus on the effects of imports on narrow, noncompetitive sectors of our economy, and undervalue the general benefits of an open trade policy. These arguments refuse to acknowledge the relationship of import policies to our export efforts. They also fail to acknowledge our favorable export position, and the fact that recent overall trade imbalances result far more from essential petroleum imports than from open trade policies. In 1980, for example, despite global economic difficulties, U.S. trade performances was relatively positive:

The U.S. current account balance, after official transfers, was in overall balance.

While the United States had an overall merchandise trade deficit of $27.4 billion, it achieved a $51 billion surplus in its non-oil merchandise trade.

The merchandise trade deficit was more than offset by a $34 billion surplus in the services sector.

In contrast to the U.S. experience, Germany and Japan ran current account deficits of $16 billion and $10.8 billion, respectively.

In 1980 while the United States showed an $10 billion trade deficit with Japan, we had an $18 billion trade surplus with Europe.

This last set of figures underscores an important point. It is counterproductive to seize upon simplistic statistics such as bilateral trade deficits. If they justify restrictive U.S. actions against Japan, they justify similar European actions against us. Also, by segmenting our balance of trade figures, we weaken our argument for improved access in services, an area in which we are clearly the world's leader. Similarly, by acceding to pressures to protect noncompetitive production in our own country, we strengthen the hand of those in other countries who press for market distorting mechanisms, including subsidies for their non-competitive production.

We have, to date, turned our back on one opportunity to take a substantial bite out of the U.S.-Japan trade imbalance. Sending Alaskan oil to Japan would lower the cost of oil transportation to Japan and lower the transportation cost of substitute Mexican oil. Surely such an economically sensible idea should not die without a thorough public explanation of why U.S. losses from foregoing the oil swap are nevertheless justified for the good of our country.

Unfortunately, U.S. import policies too often evolve on a short term, ad hoc political basis with little attention given to the effect on our broader trade efforts or the national economic interest. The current economic situation threatens to create additional political pressures for self-defeating restrictive import policies. At similar times in our history, imports have become a convenient scapegoat for broadly based economic ills.

Compounding this difficult economic situation are persistently high interest rates which show little sign of abating in the near future despite our economic downturn. Substantial differences between U.S. and foreign interest rates have strengthened the dollar to a degree which, in conjunction with weakened economies of many of our trading partners, threatens U.S. balance of payments deficits this year and next. Such deficits will not be the result of underlying trade factors or any country's trade policies, but rather of much broader international economic and political conditions. Nevertheless, these deficits will serve to strengthen protectionist pressures among those who ignore the economic complexities of today's world and point to imports as the immediate cause of U.S. economic ills.

Already, European industrialists have warned the Japanese that the EC may be forced to adopt trade restrictive measures should Japan not moderate its export flows. U.S. officials fear similar pressures and have warned Japan that trade imbalances could provoke protectionist reactions in the United States. Calls for increased protection in steel and textiles grow louder.

Worse still, blaming all our troubles on Japan blocks realistic efforts to resolve complex trade-related problems such as the comparative efficiency of U.S. capital stocks, of the U.S. labor force, and of U.S. industrial and commercial managements, as well as questions concerning the future of our agricultural productivity.

The recent talks between the United States and Japan show the inherent danger to international trade relations from such attitudes. News reports in recent weeks note administration officials warning Japan that if trade talks are not satisfactory and Japan does not show a "change of heart," the Administration may back restrictive import legislation against Japan. The impetus behind these threats is Japan's expected $15-20 billion trade surplus in U.S.-Japan trade and the continued success of Japanese automobile imports in a declining U.S. automobile market.

AAEI supports Administration efforts to remove any barriers to U.S. exports. Yet even if threats induce a Japanese "change of heart," bilateral trade imbalances will not disappear. Nontariff barriers to U.S. exports in tobacco, beef, citrus, and other products, while substantial and unacceptable, are but a fraction of the current U.S.-Japan trade imbalance. To illustrate, the removal of all Japanese agricultural quotas might lead in five years to a net trade benefit of $500 million, according to our embassy in Tokyo. Nevertheless, the domestic political strength of Japanese (and of French) farmers, which maintains the roadblocks to our agricultural exports, must be met by our own continued vigorous battle against subsidies affecting foreign markets.

We cannot pass on without noting the irony inherent in the improvement in the Japanese competitive position which would flow from a reduction of their food costs to international levels. The reform of their complex distribution systems is also a benefit and a drawback to our competitive system.

Much more important is the current dollar yen exchange rate. Also, more important are attitudinal differences toward trade which we Americans must overcome if we are to compete successfully. This was pointed to by U.S. businessmen competing successfully in Japan, quoted in the "Special Progress Report," the 1980 study of the American-Japanese Trade Study Group:

"We recognize that this trade imbalance has resulted more from the disparity between the efforts made by Japanese exporters to develop U.S. markets for their goods and the efforts made by U.S. companies to develop markets for their goods than from any remaining Japanese non-tariff barriers. The Japanese government's positive attitude towards the export efforts of Japanese firms has contributed to this disparity. Any long-term improvement in the bilateral trade imbalance will depend more on improved performance by both U.S. business and government in promoting exports than on the removal of remaining Japanese non-tariff barriers. We also believe, however, that remaining non-tariff barriers in Japan are a contributing factor to the bilateral trade imbalance and act as a major irritant in United States-Japan economic relations."

AAEI fully concurs with this evaluation. Protectionist threats cannot overcome trade imbalances reflective of basic U.S. economic conditions and attitudes.

Moreover as the recent example of automobiles reveals, import restrictions cannot cure an industry's basic econmic ills, and more often than not serve only to further weaken the economies of those countries imposing such protectionist policies. As noted in the ITC's November 1981 report on the U.S. automobile industry, Japan's "voluntary" acceptance of import restraints resulted in a decline in shipments of automobiles for the year ending September 1981 of over six percent from the preceding twelve months. The U.S. auto industry, however, remains in disarray as the basic problems of the industry go significantly beyond import competition. At the same time, the price of Japanese cars sold in this country has risen more than 15 percent in the past year—a normal reaction to limits on import quantities. Quotas, whether on cars, shoes, or apparel, force the exporter to limit shipments of low priced, low profit products. Quotas cost the U.S. economy more than the benefits provided to the noncompetitive industry segments they are to protect. Even threats of more restrictive automobile legislation are harmful, as they suggest that a simple remedy may exist for complex economic and structural problems.

AAEI believes that the Congress and the Administration recognize the dangers of restrictive import policies to its broader trade goals of the U.S. and to efforts to revitalize the U.S. economy. In its Statement on U.S. Trade Policy, the "White Paper," the Administration has adopted a constructive position on trade which recognizes the interrelationship among trade issues and the importance of open markets at home and abroad to our own economic well-being:

"The United States is increasingly challenged not only by the ability of other countries to produce highly competitive products, but also by the growing intervention in economic affairs on the part of governments in many such countries. We should be prepared to accept the competitive challenge, and strongly oppose trade distorting interventions by government.

"We will strongly resist protectionist pressures. Open trade on the basis of mutually agreed upon rules is in our own best economic interests, and is consistent with the Administration's commitment to strengthen the domestic economy."

The Administration's statement makes clear that its open trade policy must apply at home as well as abroad:

"Where other nations have a natural competitive advantage, U.S. industry must either fina a way of upgrading its own capabilities or shift its resources to other activities."

AAEI strongly supports the Administration in these general policy positions.

In the same vein, the Administration has put forward a positive position on trade with developing countries. Ambassador Brock in his testimony before this Committee stressed the importance of U.S. trade with developing countries, not only to assist in their development, but also because they are the fastest growing market for U.S. exports.

AAEI is concerned, however, that these laudable Administration positions on open markets and the importance of developing country trade to the United States are frustrated by U.S. actions contrary to those positions.

B. Free trade policies and the multifiber agreement

We have already noted the Administration's actions on autos as an example of the inconsistencies between policy and practice which can result when political pressures overwhelm economic logic. However, the most notable area of this inconsistency between policy and practice is in the textiles and apparel sector.

The problem of protectionism in textiles and apparel is not new, as administration after administration has felt the need to accommodate political factors. This protectionism is antithetical to the current Administration's general positions on trade policy, as enunciated in the White Paper and in statements by the President, Cabinet Members, and other officials. Administration trade policy embraces free trade, rejects protectionism, and stresses positive adjustment through market forces as necessary preconditions for a competitive and productive U.S. economy.

The position taken by our negotiators in Geneva during the recently concluded negotiations on the extension of the Multifiber Arrangement (MFA) contradicted these policies. During the course of these negotiations, the United States position was more restrictive than the existing MFA. Yet because of the EC's even more extreme posture, the United States was well placed to mediate differences between supplier countries and Europe. However, in the crucial, final days of the negotiations, the United States took a new, significantly more protectionist position that we should be able to relate import increases to the growth of the domestic textile and apparel market. Due in no small part to that U.S. turnabout, the developing countries were forced to accept a new MFA Protocol of Extension with significantly regressive elements. We fear this turnabout may complicate U.S. negotiations this year for new and/or modified bilateral textile agreements with a dozen or more supplier countries.

On the positive side, the Protocol of Extension includes significant provisions calling for more discipline in taking restrictive actions against imports, particularly with regard to substantiating claims of market disruption on the basis of "specific relevant factual information." The Protocol also reemphasizes and strengthens more favorable treatment of smaller suppliers and new entrants, as well as cotton producers and 807 trade. There is a real danger, however, that the Administration may ignore these international commitments in reaction to domestic industry pressures to relate total import increases to the growth of the domestic textile and apparel market. If the Administration bows to these pressures, the domestic textile and apparel industries will in effect be given a guaranteed market share, irrespective of their competitive positions, and the principle of positive adjustment through market forces will become a dead letter in those sectors of the U.S. economy.

One of the first tests of the Administration's willingness in this area to meet its international obligations and to adhere to its policies of free markets and adjustment has already begun with discussions regarding a new U.S.-Haiti textile agreement. Given Haiti's status as one of the world's poorest countries, a Caribbean Basin country, and a small supplier, a serious question exists as to whether Haiti's textile trade should be restrained at all, except in the most exceptional circumstances. This is particularly true since Haiti merely assembles U.S. manufactured and U.S. cut piece goods, and in view of the Administration's commitments in its Caribbean Basin Initiative to assist countries in the region through increased trade opportunities. We fear that under pressure from the domestic textile lobby, the United States will insist upon restrictions on Haiti's textile trade and exact a restrictive agreement from Haiti. This would set the stage for more restrictive actions against other suppliers.

Moreover, the U.S. textile program is operated in a way that makes it unduly subject to protectionist pressures. The Textile and Apparel Group of AAEI testified in detail on this subject last December. As was explained, the textile program fails to provide importers, retailers, and the public the most basic elements of procedural due process: there is no advance notice of contemplated Government action; no opportunity for interested parties to review the underlying information upon which such action is contemplated; and no opportunity for meaningful comment by interested parties with an assurance that any comments will be fully considered. Absent these procedural safeguards, decisions in the textile program can be and are made in secrecy, and the pressures of favored special interest groups for protection too often determine the course of government action. AAEI endorses the efforts of its Textile and Apparel Group to bring due process into textile program administration.

In addition, as the Commerce Department itself recently admitted in its solicitation for National Consumer Apparel Panel data (Solicitation No. SA-RSB-82-0011, dated December 28, 1981), the textile program presently makes decisions without the information necessary to evaluate the economic condition of domestic textile and apparel industries. These decisions are made on the basis of import data alone, without knowing whether the domestic industries producing these products are being injured by imports or need import protection. The result is unnecessary and at times irrational restrictions imposed on textiles and apparel imports.

Because of the serious deficiencies in the administration of the textile program, and the importance of this year's bilateral negotiations, AAEI's Textile and Apparel Group recommended a major review of textile policy by the Trade Policy Committee and the Cabinet Committee on Commerce and Trade, with U.S. International Trade Commission collection of domestic industry economic data through questionnaire procedures as an initial first step for such a review. We believe such a review is necessary to rationalize the textile program and to bring it into conformity with Administration's overall trade policy.

At Cancun, the President invited the developing countries to look at increased trade and the "magic of the marketplace" to solve their economic problems. He also insisted that negotiation take place in specialized international forums, such as the GATT. With 30 percent of their exports of manufactures to developed countries in textiles and clothing and a severe deficit in trade with the developed nations, the developing countries understandably looked at the MFA negotiation as a test of the sincerity of these statements. The unfortunate turnabout of the United States in the final hours of the negotiations may have called into question the GATT as a forum, at least insofar as developing countries are concerned, and as a result U.S. efforts at progressive liberalization of developing countries' own import policies may be viewed as a attempt to obtain unilateral benefits to the detriment of these countries' economic development. We hope therefore that in negotiating new bilateral agreements this year our negotiators will move toward a position more reflective of long-established and articulated American trade and economic policies, which we firmly believe are in the best economic interest of our country. We also hope that the United States will meets its international obligations under the MFA and the Protocol of Extension by taking restrictive actions only where justified on the basis of specific relevant factual information on the economic condition of the domestic textile and apparel industries.

C. Free trade policies and the U.S. generalized system of preferences

AAEI fears that this same inconsistency between open trade principles and U.S. actions may be occurring with respect to the U.S. Generalized System of Preferences, and that possible administrative and legislative actions affecting the GSP may further jeopardize U.S. efforts at developing country trade liberalization. The developing countries are an increasingly important U.S. export market.

In his testimony before this Committee, Ambassador Brock noted the importance of the Generalized System of Preferences for developing countries to help diversify their economies and increase export earnings. Ambassador Brock suggested that GSP was an important vehicle to lessen these countries' need for external aid and promote their fuller integration in the international trading system. In his testimony, Ambassador Brock announced that the Administration will seek to extend the GSP beyond its current 1985 expiration date.

AAEI concurs in the Administration's evaluation of the GSP. In contrast, however, the Administration's policy of ad hoc graduation may be weakening the program significantly.

In its annual GSP product review this year, the Administration announced its intention to continue the previous Administration's policy to "graduate" products from eligible countries, particularly the so-called major beneficiary countries. Graduation is neither necessary nor productive.

Under the current law, when annual trade in a GSP eligible product from a beneficiary developing country exceeds either the dollar value or percentage competitive need ceilings, imports of the product from that country are automatically excluded from duty-free treatment in the following year. When products are excluded from duty-free treatment on this b asis, sales of those products from affected countries decline, often markedly. This trade is most often picked up by developed countries, and to a lesser extent by other major beneficiary countries. Little benefit is gained by less developed beneficiary countries.

The exclusion of a beneficiary developing country from GSP eligibility in a product should be limited to those instances where required under the objective standards of the current law, or where a domestic industry clearly demonstrates "import sensitivity in the context of GSP"—that is, serious injury resulting from a product's GSP eligibility—in the annual review process.

An even greater threat to the continued viability of the GSP program is that of restrictive legislation. In the 96th Congress, Senators Heinz and Moynihan introduced a bill (S. 3201) to reduce substantially GSP participation for the "five major beneficiaries"—Korea, Hong Kong, Taiwan, Mexico and Brazil. This bill has been modified and reintroduced again this year as S. 1150. The primary feature of the new bill is to establish a competitive need ceiling of $250 million within an overall two-digit SIC code product sector. If imports in the sector exceed $250 million, a country would lose eligibility for all products within that sector.

Two-digit SIC codes cover an extremely wide range of products, often unrelated, which would be affected as a group under the bill. For example, SIC 39, "miscellaneous manufactures," includes jewelry, silverware, toys, sporting goods, musical instruments, office and artist materials, and products ranging from candles, pins and needles to pipes, umbrellas, zippers and tape measures. Under S. 1150, a country's large volume of U.S. trade in one or more of these products, even in products not eligible for GSP, could result in the loss of duty-free treatment for numerous other products within the two-digit sector—even though the country is not internationally competitive in those products. The bill would affect eligibility for duty-free treatment on hundreds of millions, if not billions, of dollars of trade from Taiwan, Hong Kong, Korea, Mexico and Brazil. In addition, other countries such as Singapore and Israel, may also be affected, as well as a number of Latin American countries.

These legislative efforts and the Administration's graduation policy are not consistent with a comprehensive policy toward developing countries as a whole. Rather, they represent restrictive import policies to withdraw GSP benefits from certain developing countries which will result only in reduced imports. Such actions seriously damage many of our major developing country trading partners and limit U.S. export opportunities without truly benefitting the least developed countries, or domestic industries.

D. Free trade policies and steel

The counterproductive effect of U.S. import policies on broader U.S. efforts to open markets for U.S. goods and services in other countries is also occurring at this moment in the area of steel.

This country, again, is confronted with a major crisis in steel. On January 11, seven U.S. steel companies including U.S. Steel, Bethlehem Steel and Republic Steel filed petitions seeking the initiation of 132 separate antidumping and countervailing duty investigations involving nine steel products from eleven countries. Some of these petitions were rejected by the Commerce Department because the minimal requirements of a petition were not met. More significantly, the claims of the domestic industry were so overstated that the International Trade Commission terminated 54 complaints on the basis that there was no reasonable indication of material injury or threat thereof by reason of certain steel imports. As a result, 55 cases out of the original 132 petitions continue at this time. The TPM was suspended on January 11 upon the filling of the cases. Additional cases have since been filed involving wire rod from six countries, pipe and tube from Japan, and stainless bar and rod from Spain.

The present crisis is, again, largely the result of two factors—the non-discretionary nature of the U.S. trade laws and the pressure from sectors of the U.S. steel industry. As we enter this new crisis in steel, it is useful to review the process that brought us to this point. The starting point is the TPM, which was in essence a minimum price scheme. It was created originally because the antidumping law provided the domestic industry with a virtual veto power over governmental policymaking in the steel sector.

U.S. steel producers invoked their veto power in March 1980. At that time, they filed a series of antidumping actions against European steel suppliers, resulting in a suspension of the TPM, largely because the Commerce Department refused to increase trigger prices. The industry withdrew these cases when the Commerce Department altered the TPM by (1) increasing trigger price levels—in many cases to levels above prevailing domestic prices; (2) maintaining overly broad product coverage; and introducing the concept of a "surge" under which Commerce could institute antidumping and countervailing duty cases even against imports at trigger prices.

Once the TPM was reestablished in October 1980, the Administration instituted a total of ten antidumping or countervailing duty investigations against steel products from various countries. Some of these investigations were the result of below trigger imports; some were the result of "import surges." On February 1, Commerce terminated six of those self-initiated investigations because they were duplicated by acceptable petitions from the steel industry.

In November 1981, the Administration took additional steps to satisfy domestic steel interests under the restored TPM—again under threats from the industry that it would again file an unmanageable number of cases—by ending the preclearance system. The preclearance system enabled foreign producers which could establish fair value below trigger prices to conduct business at those fair prices without the intimidation and harrassment of disruptive and expensive antidumping or countervailing duty investigations.

The Administration claimed the preclearance procedure was "unnecessary" and eliminated it. In fact, a major Dutch producers of sheet products and Korean producers of carbon steel pipe had proven to the Commerce Department—and Commerce had verified—that they could import below TPM without violating U.S. antidumping and countervailing duty laws. Rather than admit that these foreign producers could indeed fairly export steel below trigger price—a ruling which the U.S. steel industry strenuously objected to—the Commerce Department ended the program.

Given the current economic and political climate, it is also useful to review some recent activities of the steel industry while the industry was under the government protection of the TPM.

A very brief look reveals: U.S. Steel announced it would acquire Marathon Oil for $6.65 billion ($3.75 billion in cash). In attempting the second largest merger in history, U.S. Steel is offering $125 per share—a $40 per share premium over Mobil Oil's orginal offering for control of this same company; there was no change from 1980 through November 1981 in the employment of production workers and total workers in the industry; hourly earnings increased 19 percent from 1979 to 1980; through November 1981, hourly earnings increased an additional nine percent; through November 1981, only 21 percent of domestic steel production was produced by the continous casting process compared to over 60 percent for the Japanese; and through November 1981, over 11 percent of domestic steel production was still produced using old, uncompetitive open hearth furnances (the Japanese shut down their last open hearth furnance over five years ago).

In spite of these actions, which were taken to continue to mollify domestic steel producers, the response of the industry, delivered on January 11, was "It's not enough." By filing massive antidumping and countervailing duty petitions, the industry hopes the complex procedures established in the Trade Agreements Act will prove so overwhelming that the Administration will impose quotas on steel imports, the real objective of the industry.

Finally, we would like to spend a moment on the use of alleged "unfair trade practices" as an excuse for protectionism. Many industries, however inefficient, claim that foreign competitors use "unfair trade practices." This oversimplification is rarely treated to the hard questioning it deserves. Conduct that is permitted in domestic commerce is assumed to be improper in international commerce and condemned by the antidumping and countervailing duty laws solely because it is international in nature. What is involved essentially is a condemnation of differential pricing, specifically that sales for export at prices below those of the home market are "unfair."

But why should differential pricing between markets be prohibited in the first place? Why is differential pricing across the Rio Grande or St. Lawrence Rivers "unfair", but differential pricing across the Mississippi, the Ohio or the Potomac not?

A secondary premise of the antidumping laws is that international sales below cost of production also can be "unfair", yet in recent years, companies such as Chrysler, Bethlehem Steel and Lockheed have operated at losses, and therefore, presumably have sold their products below the cost of production. This may be very undesirable from their perspective, but is it "unfair"? If it is not, why is it unfair for a foreign exporter to do the same thing?

Differential pricing and sales below cost of production are not inherently evil. Nevertheless, the U.S. has attached emotionally laden, pejorative labels to this conduct—labels like "unfair" and "dumping". But the conduct to which those labels apply usually is rather ordinary in everyday commerce. It is not conduct that is responsible for the economic problems of this country.

We suggest that this Subcommittee take a serious look at the Antidumping Act and consider again whether it would not be far preferable to have a unitary statute based upon the concept of serious injury, where pricing would become only an element in the consideration of injurious impact.

There is really no need in our view for the labyrinthian procedures involved in determining fair value, or little sense in the tortured and arbitrary analysis of accounting data which is involved. Whether exports are priced below cost or below a "home market price" is irrelevant. What is relevant is whether imports are causing serious injury. We believe that no other inquiry other than that of injury is really required in order to afford legitimate protection to American industry.

IV. CONCLUSION

In conclusion, AAEI supports the broad statements of trade policy enunciated in the Administration White Paper, and by the President and Administration officials. We are concerned, however, that Administration actions, in many instances the result of domestic political pressures compounded by inflexible trade legislation, are undermining these Administration policies, contrary to broader U.S. trade interests and overall national economic interest.

It is essential that the inconsistencies between these broader interests and more narrowly inspired actions be recognized. AAEI urges that U.S. import policies be adopted with the perspective of broader U.S. trade interests in mind and that restrictive import actions be rejected as counterproductive to U.S. efforts to open foreign markets and support economic recovery.

We cannot conclude our statement without underlining the fact that the United States is not adequately countering the trends which are undermining our long-term international trade position.

Key issues affecting long-term American productivity are scarcely recognized as trade problems. We ask Congress to consider if a major institutional change is not needed to meet our present and future trade problems.

We must continuously examine the long-term quality of our basic factors of production, examine the competitive policies of our trade rivals, and find the political means to overcome our deficiencies.

Let us look, in the broadest sense, at our factors of production, land, labor, capital and management.

While our agricultural exports are a key part of our exports (and necessary to meet even the effective world demand for foodstuffs, let alone world hunger), we are allowing inadequate soil conservation practices which must surely destroy us as a major exporter of agricultrual commodities.

We lack a strong tradition of obligation to maintain the quality of the land, and we are just beginning to formulate some framework for dealing with the problem. The problem is exacerbated by the loss of prime farm land to more immediately lucrative non-farm uses, reflecting the same clash of interest.

It is common—and not incorrect—to view our rapid loss of topsoil as an agricultural problem and as a moral problem of destroying our patrimony—of irresponsibility toward future generations here and in a hungry world.

Yet this problem is also a U.S. international trade problem of great magnitude—a problem which must be solved before it is too late.

Water quality and water availability, maintenance of adequate gene pools for our crops, and research and development in agriculture are problems more readily dealt with, providing that responsibility is established for uncovering our needs, suggesting policies, education the public to the need for proper policies, and monitoring the results and new problems arising from political solutions for these problems.

The quality of our labor force, in its broadest sense, must also be examined in terms of our competitive position in international trade, and of the path we must follow to improve that competitive position. We have no future as an exporter of labor intensive products. We can maintain labor intensive production for our home market only at the cost of a continuing misallocation of our resources, continuing frictions with trading partners from whom we should expect our greatest export growth, and continuing boosts to the U.S. inflation rate. It has long been thoroughly accepted as theory that we must continue to switch from labor intensive to capital intensive "knowledge" industries.

Are we preparing our labor force as well as our trade competitors in advanced industrial countries prepare their people for high technology industries? Will we have the people capable of filling the jobs in a "re-industrialized" America? Surely not with the way things are going now.

A well-known UN study shows that our public school students do not have knowledge of math and science found in Japanese students and students in some Western European nations. We have a shortage of qualified math teachers in our high schools and our junior high schools.

We are not turning out a comparable (or adequate) proportion of engineers, and suffer from a shortage of engineering professors at our universities. Some in the business community are attempting to close this gap, but who will tell us whether these efforts restore the competitive position in quality and quantity of engineering graduates?

Industry has already complained of an inadequate supply of people sufficiently trained in foreign languages and cultures to fill international marketing positions. The same lack is seen in government.

In a competitive world, U.S. labor quality is an international trade problem. While our educators can learn from the most successful remedial programs run by some of our large corporations, some government institution must monitor our educational needs in trade terms and suggest policies capable of restoring the competitive position of our labor force. Only then can government mobilize the resources necessary to solve these problems.

A statement by a senior economist at TRW Inc., Pat Choate, quoted in the June 15, 1981, New York Times, precisely frames the problem:

"Improving the quality of the work force is the principal route to increased national productivity, particularly in the coming decade, when capital will become scarce and the technology of many other nations will be comparable to ours."

In many key industries our capital stocks are also inadequate when compared to those of other nations. If our institutions are not set up to keep our capital stocks at an internationally competitive basis, how can we do anything but slip behind those competitors more aggressively in capital formation?

A comparatively low U.S. rate of savings is one factor in our capital-short world. In part we are discussing taxes on unearned income as a trade problem.

Again, government and the public usually see broad issues of taxation in terms of social justice. Surely this viewpoint is valid, but we must also understand and act on the understanding that depreciation rates and corporate income tax levels and rules must also be judged for the trade impact of their international competitiveness.

The level of public funding and tax treatment of research and development efforts must also be recognized as international trade problems. If we cannot stop MITI, under international trade rules, from subsidizing research and development expenses in areas in which MITI feels Japanese production should advance, we must surely match the MITI effort in research and development funds. (We are not recommending expenditure of public funds to steal a march on our trade competitors. We are recommending the use of intelligence, wisdom and public money to counter those stealing a march on the United States.)

Nor do we say that all our policies must yield to international trade needs. We do say that our international trade needs must be given weight in all such policy decisions.

American management weaknesses are getting healthy exposure and some correction under the impact of the recession and of U.S. foreign trade problems. While there is discussion now, who shall continue to monitor and publicize U.S. management weaknesses? What is the solution to the problem of management over emphasis on short-term profits in an institutional set-up which rewards managements for such over emphasis? Surely this is a major problem in a world in which our major competitor holds a long-term orientation.

As we consider future problems in agriculture, in labor quality, in quality of capital stocks, in management, and add the problem of devotion to quality work we must be frightened by the breadth and depth of the challenges our country faces.

We suggest it must be become automatic to consider all our policies in terms of our international trade position as well as in the usual narrower terms.

AMERICAN FARM BUREAU FEDERATION,
Washington, D.C., October 28, 1981.

Hon. SAM M. GIBBONS,
Chairman, Subcommittee on Trade, Committee on Ways and Means, House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: Farm Bureau, representing over 3 million member families, submits the following comments with regard to the topics provided in your press release of August 7, 1981.

American farmers and ranchers view the world as the market for their products, rather than looking at the domestic market alone. As you know, a very large percentage of the production of many farm commodities is dependent on export markets. If American farmers are denied access to world markets, or suffer market restrictions, farm incomes are adversely affected. For this reason, Farm Bureau has supported government efforts to gain market access and to eliminate, wherever possible, trade restrictions which would adversely affect the exportation of American farm products.

TRADE EMBARGOES

Farm Bureau opposes government restrictions which affect access to world markets. We believe that embargoes should not be resorted to except where national security would require such action. If there is a situation where U.S. national security is threatened, Farm Bureau believes that any embargo should be imposed on all trade rather than being directed only at agricultural commodities. The embargo, which was applied to the Soviet Union in early 1980, was directed only at agricultural commodities while other export trade continued with business-as-usual.

EUROPEAN COMMUNITY POLICIES

Farm Bureau has long favored policy which would result in a strong Europe. We believe, though, that the common agricultural policy of the European Community is causing loss of income to American farmers and ranchers, not only in the Europen market but also in third country markets. As EC duties and levies have risen on many U.S. agricultural commodities, we have seen those markets decline or virtually disappear. This has been the case with U.S. poultry. Now we see the European Community subsidizing many of their agricultural commodities into other third-country markets, which traditionally have been markets for U.S. farm products. Ambassador Brock, U.S. Trade Representative, has opened complaints in GATT about EC export subsidies on wheat, flour and sugar. The Office of the Trade Representative has accepted 301 actions on poultry and sugar; and 301 complaints on canned fruits, pears and raisins are under consideration. Farm Bureau opposes the use of export subsidies. We must not permit the EC to build an "export machine" by the force of their treasuries.

BILATERAL COMMODITY AGREEMENTS

Farm Bureau opposes the proliferation of bilateral commodity agreements such as those with the Peoples Republic of China, Mexico and the Soviet Union. We believe that U.S. farmers and foreign buyers fare better in open market arrangements. We especially oppose the maritime agreements which accompany the commodity agreements. These agreements require that a share of commercial purchases be shipped on higher rate American flag vessels. Farm Bureau feels that commercial customers of American farm commodities should be permitted to provide the transportation for those purchased commodities on their own vessels or to ship on other flag vessels at the lowest cost available in the transportation market.

EXPORT FINANCING

We support the Administration's effort to move away from subsidized interest rates which have become so prevalent in export financing, especially in Europe. Interest rates for export financing below the cost of money in commercial markets is another form of subsidy. We have supported CCC export financing because that program has been and is administered so that interest rates were not, and are not, subsidized (neither for direct loans nor for guaranteed loans).

GRAIN MARKETING BOARDS

Farm Bureau vigorously opposes national grain boards. We have opposed legislation which would create such boards within the Commodity Credit Corporation and, more recently, we have opposed proposed legislation which would have required the Secretary of Agriculture to set minimum export prices on certain farm commodities. We believe that the actual trading of farm commodities—and the prices, terms and conditions of such trade—should not be dependent on, or influenced by, political decisions of the government.

The incentives and disciplines of the free enterprise system motivate exporters to aggressively seek new and expanded markets. Government lacks this important and essential motivation for market expansion. We do not want export opportunities contingent upon government approval of prices or terms of trade. The interests of American farmers in world markets can best be served by private exporters, including farmer-owned cooperatives. These exporters have the expertise, the facilities, and the incentive to aggressively seek trade expansion. Farm exports are too important to be left to government.

The government has a role—a very important one—in facilitating the exports of farm commodities by sound economic policies. That role involves such matters as negotiations with regard to international trade restrictions and trading rules, grain inspection, cooperative market development, operation of trade centers in foreign markets, a worldwide agricultural attache service, operation of the P.L. 480 and CCC credit programs, and assurance that the market is free of anticompetitive practices.

EXPORT PROMOTION

Farm Bureau is a strong supporter of the P.L. 480 program and the market development program of the Department of Agriculture. Our agricultural attache system, trade centers, and the market development cooperator program, under which industry and government cooperatively promote U.S. farm commodities, are essential to maintaining and building world markets for farm products.

PRIVATE SECTOR ADVISERS

We work closely with the U.S. Trade Representative's office and support their efforts to gain access to markets for American farm products and to lessen existing restrictions. Farm Bureau was a strong supporter of the Geneva trade talks and the implementation of the results. Farm Bureau serves on the various advisory groups to the U.S. Trade Representative, and the president of the American Farm Bureau Federation serves on the Advisory Committee for Trade Negotiations and the Agricultural Policy Advisory Committee. We shall continue to work with the U.S. Trade Representative's office to accomplish increased trade in agricultural commodities.

We appreciate the opportunity to comment on these topics.

Sincerely,

VERNIE R. GLASSON,
Director, National Affairs Division.

STATEMENT OF THE AMERICAN INSTITUTE FOR IMPORTED STEEL, INC.

The American Institute for Imported Steel, Inc., founded in 1950, is composed of 60 American companies invovled in the importation of steel products. The Institute appreciates the invitation by the Trade Subcommittee to submit its views, in writing, for the private sector phase of oversight hearings on U.S. trade policy.

The Institute understands that a vibrant American steel industry is necessary for the U.S. economy and also is in the best interests of the American steel import community, because of the supplementary support role steel imports play in the economy.

However, the Institute does not see import restrictions as contributing to the well-being of the domestic steel industry. The failure of past and current excursions into protectionism attests to that fact.

We had the voluntary restraint program restricting steel imports in the late 60s and early 70s and import quotas for specialty steel in the mid-70s. We still have the trigger price mechanism, the U.S. Department of Defense prohibition against purchases of foreign specialty steels, the prohibition by the Public Roads Administration against imported structural steel, the Foreign Aid Program requiring purchase of domestic steel regardless of price, and a multitude of local and state "Buy American" restrictions. Both the industry and, recently, the government have brought a number of actions under trade laws seeking to curtail imports. All of these activities have been counterproductive. Restraint of import competition in the American steel industry generates a malignancy that spreads into other sectors of the U.S. economy without assisting the steel industry or its workers.

We favor establishment of programs to help solve steel industry problems. But we object to anti-steel import measures which not only fail to respond to American steel industry problems and aggravate them but also create problems elsewhere in the U.S. economy.

Quotas and measures resulting in artificially high prices which are above world market levels in the long run benefit no one in this country, including American steel producers and the steel workers.

ADVANTAGES OF IMPORTED STEEL

There are several areas where foreign steel plays a significantly beneficial role to the U.S. economy. The markets for particular steel products are continually changing. In some cases, the market demand for a particular steel product may exceed the production capabilities of domestic mills. Under these conditions where foreign suppliers can fulfill the added requirements they help prevent what could be serious dislocations or limitations to growth opportunities. The recent shortage of pipe for oil field applications is a good example where foreign steel has provided real economic benefit even beyond obvious cost advantages.

With the high capital cost of constructing new steelmaking facilities it does not make good economic sense to build and maintain the steel capacity needed to meet peak demands and then have idle capacity during slower economic periods. The same dollars can be used much more productively and profitably in high technology growth industries. Foreign steel imports are of particularly economic benefit during those periods when steel demand exceeds domestic capability.

In a large country such as the U.S., regional steel production does not always match the growth in regional steel demand. On our west coast some steel products, if ordered from domestic mills east of the Rockies, carry a burden of more than $100 per ton freight compared with $50 per ton freight from European coastal mills and only $40 per ton from Japanese sources. Obviously, in these cases foreign steel presents a sound economic advantage to industries in the area even if all other conditions were equal. Geographical advantages are not static but are continually changing due to changes in transportation costs or changes in the capacity or the product mix of regional domestic mills.

In the areas of quality, marketing and on-time delivery, the performance of foreign steel suppliers is generally equal to or better than the performance of domestic mills. The study of the American steel industry, released in January 1981, by the U.S. General Accounting Office, confirms this point.[1] The GAO surveyed over 100 American steel-buying companies to investigate why foreign-made steel is purchased. The GAO report concludes that decisions to buy foreign steel depend not only upon price but also upon quality, product availability and marketing services and attitudes. The report established the following:

(1) Price considerations—In addition to having lower ordering prices, foreign firms contract to sell at firm prices. American steel firms charge the price in effect at the time of delivery.

American mills do not control dimensional tolerances as well as competing foreign steel mills and some American mills bill for actual weight delivered rather than theoretical weight. Consequently, customers pay for additional undesired weight.

Also, according to some respondents, domestic mills could be more competitive if they offered discounts for volume purchases. Lastly, buyers criticized U.S. mills for following suit each time a major American steel mill publishes a new price list.

(2) Quality—As a general rule, buyers felt the newer, more modern facilities outside the United States permit foreign steel mills to market products of superior quality. The firms contacted provided numerous examples of foreign steel superior in gauge control, consistency, fabrication, and processing.

A company producing tubes for hydraulic cylinders obtains steel containing .004 percent sulphur from foreign mills, whereas the standard domestic mill grade contains five times as much. U.S. mills will take orders for sulphur levels of .015 percent at a $10-per-ton premium. The company's purchasing manager explained their foreign suppliers can readily produce lower sulphur steel because they use modern processes and have better quality control. The low sulphur content means tubes can be produced with less waste.

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[1] "New Strategy Required for Aiding Distressed Steel Industry," Report to the Congress by the Comptroller General, U.S. General Accounting Office, EMD-81-29, Jan. 8, 1981.

Another company, fabricating disposable steel containers for agricultural chemicals, purchases commerical-grade flat steel products. The Japanese and Australian steel is uniformly thick, whereas the American product varies, causing production machinery to jam, or resulting in loose fitting cans. The domestic steel carried rust, mill scale, and holes, even though it was supposed to have been inspected at the mill before delivery.

(3) Product Availability- The companies interviewed frequently cited as reasons for buying foreign steel unavailability or restricted sources of certain steel mill products. They said U.S. mills are reluctant to roll steel to thin dimensions, partly because they have sufficient customers for thicker products, which are less costly to produce, and partly because their mills are too old to maintain the specific tolerance required for thin sheets. Buyers told GAO lack of domestically-made thin wall or narrow gauge steel is not peculiar to the west coast, it is a problem in many other parts of the nation as well.

West coast companies explained that some mill products not available from western steel mills are produced elsewhere in the United States. However, freight costs preclude their purchase from midwestern or eastern steel mills.

Unless domestic steel mills become more responsive to new product needs, U.S. firms will turn increasingly to foreign mills and this will result in an even greater dependence on foreign-source steel.

(4) Marketing Services and Attitudes—Many buyers referred to the "take it or leave it" sales philosophy of U.S. steel firms. The report quoted the owner of a large steel service center as saying: "The overseas firms are more flexible and willing to work with you. They act as if they need you rather than you need them. The most important element," he said, "is that there is no sense of urgency in domestic firms to work with the customer."

Automakers responding to GAO pointed out the need for adequate large-scale domestic production capacity to supply dual-phase steels having better formability than conventional high strength steels. To properly make these steels which are essential to production of more fuel-efficient cars, domestic steelmakers have to install continuous annealine lines. But they have lagged behind foreigners, particularly the Japanese, in installation of this new technology.

GAO said if American steel producers are to regain lost domestic customers, they will need both newer and more productive facilities and a more customer-oriented approach to marketing products.

The ramifications of high cost steel and of the other GAO factors can be seen in the metalworking industry. American metalworking companies have become less competitive. Finished competitive products imported from abroad are hurting their position in the world metalworking market.

Many U.S. metalworking enterpries are now manufacturing outside the U.S.—in locations such as the Philippines, Korea, and elsewhere—where they can buy steel, other raw materials and services, at world market prices, significantly lower than those paid in the U.S. These competitors and others, in Japan, Southeast Asia, Latin America, pose a serious threat to metalworkers operating in the U.S. Protection for the steel industry increases costs of U.S. manufacturers who use steel. That, in turn, makes them less competitive. This trend is a threat to job opportunities in the U.S metalworking industries which employ twenty times as many people as steel and have ten times steel's share of the GNP.

There is an artificial wage differential between steel and other manufacturing wages in the U.S. Total hourly compensation for production steel workers in the U.S. is almost 80 percent higher than the average manufacturing wage. Artificial protection of a high price level in the industry would merely serve to make this differential a permanent part of the U.S. economic scene and to force the rest of the working population to subsidize the steel workers.

The Institute is deeply concerned with the recently announced antidumping and countervailing duty actions. Our concern is intensified by the threats of additional actions in these areas coming from sources which have the ability to initiate such proceedings.

It is shocking that American steel mills are blaming steel imports for their problems when they are the exclusive buyers of what may be 1.2 million tons of steel slab imports in 1981 and have ordered over one million tons of pipe and tube imports this year.

In the first 11 months of 1981, the increase in steel imports springs entirely from larger shipments of semi-finished steel slab and tubular oil country products. Purchases of slab imports, averaging 100,000 tons per month, were exclusively made by American steel mills, the only U.S. operations which can process slabs.

U.S. Steel and Armco have publicly announced buying a combined total of over one million tons of pipe and tube imports in 1981. This is only the tip of the iceberg of such purchases by American steelmakers due to their inability to meet U.S. demand.

In other words, if increases in slab and tubular products are subtracted from steel imports in the first 11 months of 1981, the level of imports is almost the same as the first 11 months of 1980. It therefore appears American steelmakers are still purposely misleading the U.S. public.

OUTLOOK FOR THE FUTURE

The Institute believes that is is possible for the American steel industry to compete, providing it has the will to tighten its belt and work hard. There are those who look at the problems of the primary steel industry and the high cost of modernization and conclude that in the future the U.S. industry will be smaller and less competitive in world markets. They may be underestimating basic strengths and resources. The U.S. does have some important comparative advantages. There is the abundance of scrap, coal and iron ore. Energy costs are equal to or lower than most other steel producers. Almost without exception, major steel companies are increasing the percentage of steel produced by the continuous casting process and otherwise modernizing their facilities. While they still lag behind Japan and Europe in this respect, they have started a serious and credible move to catch up. The imposition of nontariff barriers do not facilitate this process. They only serve to delay its implementation and penalize the consumer with higher steel costs.

The Institute believes protectionism prevents closing of inefficient mills, increases production costs, and fuels inflation. It weakens the competitive position of American industry. In the absence of protection, only newer, more competitive plants would survive, strengthening the American steel industry and permitting American users to buy steel wherever they wish.

The Institute urges the U.S. Government to adopt a policy of free trade in steel and to eliminate policies instituted to protect outmoded and inefficient facilities.

Rather than discourage foreign steelmakers with a multitude of protectionist devices such as the TPM, "Buy American" rules, quotas, surge mechanisms, etc., we must encourage foreign steelmakers to consider the United States an ongoing market receptive to the best they can provide in quality, technology, price and service.

The government is not going to make the steel industry competitive. The industry itself must do that. It will all take time—but it is possible for the domestic steel industry and foreign steel suppliers to compete in an open market and provide the U.S. economy with the best possible values in steel products.

STATEMENT OF ROBERT P. HARTZELL, EXECUTIVE VICE PRESIDENT, CALIFORNIA ASSOCIATION OF WINEGRAPE GROWERS, SACRAMENTO, CALIF.

Mr. Chairman and gentlemen, my name is Robert P. Hartzell. I am Executive Vice President of the California Association of Winegrape Growers (CAWG).

I am pleased to have the opportunity to testify at these hearings on international trade issues. International trade is becoming an increasingly important priority within the membership of our organization and for that matter with the entire U.S. wine industry.

Before addressing specific issues of major importance to us, I would like to familiarize you briefly with CAWG. We organized in 1974. Our purpose is to stimulate the economic advancement of California's winegrape growers and serve as a strong, united voice in addressing growers' major concerns. Further, to take positions on key issues affecting growers' interests in the wine industry. Basically, we represent California's winegrape growers in state and federal matters where our growers' interests can best be served by strong, collective group action. At this time, we represent growers of approximately 55 percent of the available tonnage of grapes crushed for wine in California.

The wine industry, comprised of both growers and vintners, has many common goals and challenges relative to the marketing, sales, distribution and promotion of wine. It is only in the priorities of attention that we may differ and these priorities are directly related to the function of the grower and the vintner in the industry.

I would like to direct my comments to three areas: (1) The impact of wine imports on winegrape growers and the inequities that exist in foreign market access; (2) the importance of technical consultations on wine with the European Economic Community (EEC) and the urgency of rescheduling these consultations which were unfortunately postponed by the Treasury Department due to uncertainties associated with funding of their alcohol regulatory responsibilities; and (3) the necessity of extending the President's trade negotiating authority as outlined in Section 124 of the Trade Act of 1974.

First, let me discuss the current situation regarding the export and import of wine in the U.S. and the impact that it is having on winegrape growers. The 1980 U.S. wine export figures brought joy to many growers' hearts. U.S. wine exports rose 52 percent—from 5.2 million gallons in 1979 to 7.9 million gallons in 1980. Through June 1981, export shipments were again up by 51 percent over the same six month period in 1980. That, indeed, is fast-track progress.

But—let us not celebrate prematurely. Let us rather look at the data within the context of overall international wine trade. Let us take a look at wine imports to the U.S. In 1980, they were 102,100,000 gallons—up 11.3 percent over 1979. If the trend set during the first six months of 1981 continues, wine imports for 1981 will have increased by another 11 to 12 percent over 1980. Most imports are from Italy, France, and Germany with Italy accounting for about 60 percent.

Therefore, we have the situation where U.S. wine exports are only about 8 percent of wine imports, but U.S. wine exports have increased dramatically percentagewise in the past two years. However, while exports increased by 3.8 million gallons between 1978 and 1980, imports of wine increased by 8 million gallons—over two times the amount we exported.

In monetary terms, the total value of U.S. wine imports in 1980 was $689.1 million while the total value of U.S. wine exports was only $29.9 million, resulting in a trade deficit of $659.2 million.

About one-half of U.S. wine exports go to Canada, another sizable amount went to U.S. possessions (Puerto Rico, Virgin Islands, etc.) with only about 1.2 million gallons able to enter the EEC where almost all of the 100 million-plus gallons of U.S. imports originate.

Now, I will describe the effect of the imbalance between wine exports and wine imports and the enormous increase imports is having on the California winegrape grower.

California growers produce about 90 percent of the grapes that are crushed for wine in the U.S. However, wine is a commodity traded internationally at the rate of about one billion gallons per year. This represents about 12 percent of the total global production, now approximately 8 billion gallons per year.

California contributes only about 4.5 percent annually to world wine production. Europe, including Russian production, is about 72 percent. My point is that California is pretty small potatoes in world wine production—yet, we're practically all of the U.S. wine production.

The scene today is that Europe is a virtual "lake of wine" with over 100 million gallons flowing across the Atlantic very freely into the dramatically growing U.S. wine market. In fact, while all shipments of California wine increased by a respectable 163 percent between 1970–1980, all wine imports to the U.S. grew 347 percent and Italian wine imports to the U.S. increased by 1,329 percent.

Why? Because the U.S. wine market is the "shining star" in the world today and we have negotiated away much of our tariff protection so that foreign wines can move into our market very readily.

So, growers are living with the situation where foreign wine sales in the U.S. are increasing at a more rapid rate than are U.S. produced wine sales to both domestic and foreign markets, and thus reducing and softening the demand for U.S. and California produced winegrapes. The fact that imports are capturing so much of the growth in U.S. wine market has resulted in a static grape price situation to the grower while his costs keep increasing dramatically. This has resulted in many vineyards being sold and generally hard times for many winegrape growers.

United States produced wines are continuing to lose share of the U.S. market. During the 1970–1980 period, all wine produced in the United States lost 10.6 percent market share to imports. That loss represents the product of approximately 42,000 acres of grapes which could be growing in the U.S. but which, instead, are being supplied by European growers.

Projections indicate that imports will continue to increase and that by 1990, 300 million foreign gallons of wine will enter the U.S.—three times the 1980 amount. That will result in another 7% loss in market share, equivalent to a loss of another 24,500 acres of grapes that could be grown by U.S. growers, but which will instead be grown by foreign growers.

The obvious impact of the dramatic imbalance between imports and exports is that wine's contribution to the balance of payments of the U.S. is and will apparently continue to be seriously negative.

Today, California's growers of winegrapes see that unrestructed pipeline which continues to flow from the "lake of wine" in Europe as among their most serious and long-term problems. Furthermore, that American wine consumers are plugging into that pipeline at a higher rate than into the domestic wine pipeline, is of great concern. But, of equal importance is the fact that the pipeline from the U.S. to the EEC countries and other potential markets is plugged at the discharge end by numerous protectionist tariff and nontariff barriers.

Put yourself in the position of California's winegrape growers who have invested about $6 billion in vineyards. Once they have invested the $10 to $14,000 per acre plus the cost of land at $4,000 to $15,000 per acre, they have an operation that produces 6 to 10 tons of winegrapes each and every year and should continue to do that for 20 to 30 years.

That 3 million tons of winegrapes which are produced each year in California must be purchased by a winery each and every year or they rot on the vine. Wineries, on the other hand, need only purchase their market needs, or they can go to Europe and purchase wine for import into the U.S., as some are doing today.

The point is that once the planting commitment is made by the grower, he must work to see that all possible marketing channels are open and available to him in that he is going to have 6 to 10 tons from each of his acres each and every year. He is completely inflexible. There is no spigot to turn on or off the supply. It comes, must be sold, or it rots and he's out of business.

Our Association has worked with U.S.T.R. and others to help in preparation of the President's Report to the Congress on foreign tariff and nontariff barriers affecting United States exports of alcoholic beverages. This report was presented to you in December 1981 pursuant to Section 854(a) of the Trade Agreements Act of 1979.

This report details current tariff and nontariff barriers by country and is the necessary first step to begin negotiations to remove the barriers that are seriously restricting the ability of U.S. wines to flow in export pipelines.

It is obvious, Gentlemen, that our industry needs greater access to foreign markets and we need our government's help in reducing the tariff and nontariff barriers that prevent us from penetrating markets in Europe, North America, and Asia which have tremendous potential for the sale of U.S. wine. Towards that end, we are urging Congress to extend the President's negotiating authority under Section 124 of the Trade Act of 1974 for two years beyond January 3, 1982 and request that a significant portion of that authority be used for bilateral negotiations on wine with our foreign trade partners.

If American wine is given the opportunity to compete in foreign markets on a fair and equal basis, we know that the value of exports can be increased many-fold and what is now a staggering trade deficit on wine can become a more balanced picture. We urge your support of the legislation introduced by Congressmen Sam Gibbons and Bill Frenzel (HR 4761) and in the Senate by Senators John Danforth and Steven Symms (S 1902) to extend the President's negotiating authority and, furthermore, urge you to direct that priorty be given to obtaining concessions for American wine so that we can compete in the markets where our share can be dramatically improved by the reduction of unreasonable and unwarranted tariff and nontariff barriers.

Now, let me turn to an item of utmost urgency to winegrape growers and their interest in expanding their foreign markets, I am referring to the ongoing technical consultations with the EEC regarding enological practices and standards. The negotiations have been conducted by the Inter-Agency Wine Committee and the Regulatory Group of the Bureau of Alcohol, Tobacco and Firearms (BATF). This dialogue with the EEC has been going on for six to seven years and significant progress and agreement has been made with the EEC on standards, practices, certification, and quality matters.

This October, negotiations and consultations, based on this patient exchange of technological data, were to commence between our government and EEC counterparts. Unfortunately, it was felt necessary to postpone negotiations in light of the pending phase-out of BATF. It was the feeling of Treasury officials that the integrity of U.S. commitments could not be maintained without an appropriate enforcement vehicle to implement the EEC agreements. These circumstances have caused a serious disruption in the technical consultations which dramatically impact on future sales of American wine to the European community.

For the U.S. to participate in the world market requires the indepth involvement of our government in quality inspection and certification. Most foreign buyers will not buy our wine without indepth government programs. There is no alternative to this function, It cannot be performed by a private sector group.

CAWG has two related recommendations to make to this committee regarding this matter.

(1) First, it is imperative that the alcohol regulatory function of the Department of Treasury be maintained, staffed at an operational level of expertise and adequately funded. We are specifically referring to the functions that relate to standards, label approval, enological practices, certification and quality assurance. We feel that, if it is necessary in view of budgetary considerations, that this function could be carried on withina separate regulatory office within the U.S. Customs Service.

(2) Secondly, we strongly recommend that the negotiations postponed in October, 1981 be rescheduled promptly so we can continue and finalize the understandings reached with the European community during the past six years.

Finally, Mr. Chairman, let me add these thoughts regarding the attitudes and principles of CAWG. We are not protectionists—we are fair traders and consistent with the attitude of this Administration, we believe in the free, open, competitive marketplace. We recognize the damage of setting up barriers to imports and the ensuring reciprocity which may occur. But, as fair traders and realists, we do strongly believe in the same access for our wine to foreign markets that we provide foreign wines to our markets.

As winegrape growers, our existence and financial well-being is based on supply and demand. With the increasing flow of foreign wines into this country, the demand for American wine has been reduced and that has meant static prices for California wine-grape growers. Very simply, Mr. Chairman, the price we receive for our grapes is directly related to supply and demand and increasing imports have softened that demand. To improve the demand of our wine and to remain non-protectionists in our approach, we advocate expanded exports of U.S. wine.

Mr. Chairman and Gentlemen, we believe it is time for our government to place wine on the top of its negotiating list. We can no longer tolerate a $659 million trade deficit in wine. For too many years, wine has been a bargaining chip for other commodities. This was true in the Kennedy-round of trade negotiations. As far as the recently concluded Tokyo-round is concerned, while we did not give any further concessions on wine, we certainly did not gain much either.

We appreciate the opportunity to appear here as winegrape growers representing the majority of non-winery owned grapes in California. We are seeking a greater concern for our plight within the legislative and executive branches of the federal government. We ask you for your vigorous support of directives that will increase the competitiveness of U.S. wine in foreign markets.

Thank you.

STATEMENT OF THE COMPUTER & BUSINESS EQUIPMENT MANUFACTURERS ASSOCIATION

INTRODUCTION

The 1980's begin with portents of complex trade issues and serious new trade problems for American industry. This decade will demand realistic new U.S. trade policies. CBEMA believes U.S. trade policies for the 1980's must be founded upon firm recognition and full consideration of the following facts and prospects:

Competition in world markets from both developed and developing countries will intensify, including competition in products where the United States may once have had a competitive edge.

Despite some recent improvement, the United States' share of the total world market for manufactured goods has been declining for decades.

Governments will continue to increase their involvement in domestic economies. Continuing world-wide problems with energy, monetary instabilities, and inflation will tempt them to seek national solutions. They will intervene whenever expedient to assist their domestic industries.

Almost without exception, other nations have given a higher priority to exports than we have. Lulled by our large home market and by illusions of greater self-sufficiency and independence, we have paid little heed to encouraging exports caused by a wide range of our domestic policies.

The United States will grow more dependent, first, upon exports to generate home-market growth and jobs and second, upon imports for essential materials and products, payment for which must come from U.S. overseas earnings.

U.S. high-technology industries, such as those CBEMA represents, will increasingly face foreign competition in which the government is either a major partner or even the competition itself. Today, the U.S. computer and business equipment industry must compete with government-supported enterprise abroad. Tomorrow, it will have to compete more and more with enterprises which need not earn profits to attract capital, which enjoy insulated home markets, and which can undertake high-risk ventures without the usual consequences of loss or failure.

CBEMA believes only one response will counter such prospects. It remains dedicated to the proposition that expanding, freely determined fair trade and investment will benefit all parties, including U.S. firms and their employees.

CBEMA believes this reponse will be particularly appropriate for U.S. high-technology products, long a major contributor to total U.S. exports and a major offset to a weakening U.S. balance-of-payments position. A policy seeking to expand world trade and investment opportunities would be proper even if our competitive advantage in such products continues to erode as technology spreads and competitive advantage equalizes. To reach these goals in a more competitive, changing world, CBEMA recommends the following:

THE MTN MUST BE IMPLEMENTED AGGRESSIVELY

The Multilateral Trade Negotiations (MTN) under the GATT achieved their immediate purpose. Temporarily at least, they shored up the international trading system by creating new rules of behavior and new international disciplines. While in progress, they also helped prevent any major backsliding under the stresses of competition in a turbulent trading world.

U.S. producers of business equipment and their employees stand to benefit directly from significant tariff reductions in the MTN. The Government Procurement Code, has the potential to open up significant new overseas markets for U.S. products. The Standards Code should restrict tendencies abroad to employ technical and other standards to discriminate against imported products. And the Subsidies Code, by curtailing use of export subsidies and creating new disciplines and recourses for domestic practices harmful to trade, should fill a long-standing gap in the GATT rules of conduct and competition.

The results of the MTN, however, will remain but a mere gesture of multilateral good intentions unless its commitments are, in fact, carried out and its promises fulfulled. How its Codes are administered and its new procedures for dispute settlement made effective will largely determine the course of world trade in the years ahead. The ultimate test of success will depend upon voluntary compliance and fair but firm enforcement. The United States, as the largest trading nation, has much to gain from success—and much to lose if the new commitments remain empty promises.

CBEMA also strongly urges U.S. trade negotiators to make major efforts to complete the MTN's "unfinished business":

Canada has not agreed to implement the Customs Valuation Code when the United States and other signatories put it into force. This delay by our most important trading partner will seriously affect U.S. exports. The U.S. Government should make every effort to obtain Canada's full participation in the Code at the earliest possible date.

Another major trading partner, Japan, must be persuaded to participate fully and to assume all of the Procurement Code's obligations.

The scope of the Procurement Code must also be broadened. It must include the growing—and usually government-dominated sector of telecommunications. It must also include the growing province of government business and service entities. It should include educational institutions and service contracts.

Too few developing nations assumed any significant new obligations in the MTN. Certainly, the more industrially developed nations among them must be brought within the trading system.

A notable failure of the MTN was its inability to reach agreement on the Safeguards Code. A world of intensifying competition among nations must have a workable and working agreement on the circumstances and procedures for taking emergency action when injury occurs to a domestic industry.

Completion of the unfinished business and implementation of the MTN agreements are matters of deep importance to CBEMA. Governments are increasingly major consumers of high-technology products, directly or through their extensive influence in domestic economic activity. As they become more deeply involved in day-to-day economic policy and management, governments will face critical choices between permitting world market forces to operate, as their MTN obligations essentially mandate, or reverting to discrimination, subsidy or other forms of preferential treatment. CBEMA believes it is in the interest of all MTN signatories to abide by the rules, to provide careful and fair implementation of them, and to exercise restraint in taking action against import competition.

As spokesman for the computer and office equipment industry, CBEMA urges that it give careful weight to the following considerations:

Virtually all major developed nations, along with a growing number of the more advanced developing nations, clearly recognize the strategic role of their data processing industries and their needs for such industries, as well as the ripple effects upon their economies.

In contrast, for all too long and too often, the United States has adopted laws and regulations based primarily on domestic considerations—political, economic or social—with often internally inconsistent results. Too often, as well, the results have been directly inconsistent with the needs of both the data processing and other U.S. industries to expand U.S. trade and foreign investment.

By such means as European Community-wide standards, preferential procurement, financial assistance and rationalization of production, the E.C. is currently developing a scheme to capture no less than one-third of the world's computer, telecommunications and micro-electronics market by 1990. The United States must guard against any E.C. violation of the spirit and letter of the MTN commitments in pursuit of such an objective—a violation critically injurious to U.S. industry and its export potentials.

Other governments are also involved in promoting their data processing industries—through equity participation, subsidies, preferential procurement and a variety of other means. These, too, must be brought within the rules negotiated in the recently concluded MTN.

EXPORTING AS A MAJOR NATIONAL OBJECTIVE

With the MTN largely in place, CBEMA believes it is now imperative to give exporting its proper rank in our national priorities. The problem and solutions for the declining U.S. trade position have been studied for decades, only to grow more complex and urgent. The problem has been the subject of Congressional hearings, of national commissions and of successive Presidential mandates.

Despite this attention, our trade deficit has grown, and the strength of the dollar hinges critically upon our overall trade performance. More than ever, it is time to improve our performance and time to regain a more satisfactory share of world markets.

CBEMA particularly recommends that action toward this goal concentrate the following measures:

Export disincentives to be removed need a series of positive policy decisions and firm actions. CBEMA urges consideration of (1) greater restraint in the use of any export controls to be justified on foreign-policy grounds, (2) removal of defects in the Foreign Corrupt Practices Act, (3) attack on non-tariff barriers not dealt with in the MTN. All these unnecessarily and unfairly impair U.S. performance abroad. Moreover, the competition need not submit to such self-defeating practices.

Legitimate and reasonable export promotion measures should be adopted. Trade company-type activities should be encouraged and supported, as they are abroad. The ambiguities in law and the strict interpretations in administration which have stultified recourse to the Webb-Pomerene Act should be rectified: the antitrust exemption should be more clearly specified and broadened. Formation of consortia for major offshore projects should not be intimidated.

America's competitors also encourage domestic investment and capital formation more aggressively. It is time to recognize the crippling inroads of inflation upon our traditional concepts of depreciation. We must continue to compete in provisions for accelerated depreciation and in incentives for new capital formation.

Despite recent improvements, Export-Import Bank programs still do not compete fully with the export credit facilities available abroad. Until a meaningful and enforceable international agreement can be reached on the terms of permissible financing, the United States should be able to match rates and terms underwriting the bids of our competitors. The Export-Import Bank, therefore, should be given increased size, scope and flexibility. Given its positive fiscal contribution, the Bank should not be included in the Federal Budget accounts.

Virtually all Government programs, here or abroad, have a common bottom line—their impact on national productivity and international competitiveness. They affect the attractiveness and rate of new investment. They affect the basic dynamism of an economy, particulary its high-technology, high-risk sectors. CBEMA members, part of U.S. technology's leading edge, urge that all Government policies be appraised for their competitive implications and contribution to increased international productivity.

A MORE AGGRESSIVE FOREIGN INVESTMENT POLICY

CBEMA believes trade and investment are two sides of the same coin. Their interaction provides mutual support for each other in world competition. U.S. policy, by the same token, should promote these interrelationships. CBEMA, therefore, recommends the following investment policies and programs:

CBEMA opposes efforts which would restrain or unfairly deal with the ability of foreign investors to invest here, just as it opposes counterpart efforts by foreign governments to restrict or condition capital flow from the United States. Both distort trade flows and prevent maximum benefit.

CBEMA believes, however, that the U.S. policy of "neutrality" towards American investment abroad should be re-examined. While it once may have had some theoretical or salutory justifications, in reality, U.S. investment is not always treated in a neutral fashion by the host country. We should recognize this reality and support U.S. investors subject to unfair treatment or harrassment abroad. Our goal should be to enforce "national" treatment for investments, just as "most favored nation" is the basic precept of our trade policy.

European countries have long benefitted from extensive networks of bilateral investment treaties, especially with developing countries. These networks greatly enlarge opportunities for both trade and investment and, crucially, also afford greater predictability. The United States, long wedded to general treaties of Friendship, Commerce and Navigation, should now seek bilateral investment treaties with specific provisions to assist and protect U.S. foreign investments, especially in developing countries.

Such an approach, CBEMA believes, is clearly preferable to the sweeping solutions represented by various U.N. codes of conduct. Their typically vague language leads only to serious differences in application to such issues as coverage, differential treatment and public enterprises, or over the specific nature of the agreed extent of obligations and responsibilities.

Open, more realistic foreign investment policies benefit all parties. In particular, they significantly benefit the U.S. domestic economy in terms of jobs created, jobs dependent upon investment-related exports, and these jobs' overall contribution to economic growth.

TAX POLICY FOR INTERNATIONAL COMPETITION

CBEMA's tax recommendation corrolate with its proposals for U.S. trade and investment policies. U.S. tax policies impinging directly upon our performance in world markets have often been a by-product of domestic considerations. Their adverse consequences on U.S. competitiveness seldom were made up for by the domestic benefits—either in law or in application.

Among the many proposals in this complex area worthy of serious review and implementation, CBEMA emphasizes the following:

The U.S. should not dogmatically or short-sightedly impose tax burdens upon its ability to compete. In a world of diverse tax philosophies and systems in which other nations manipulate tax policy to promote their national objectives, the concept of tax "neutrality" may have certain merits which should be considered.

The so-called "unitary system" of income apportionment used by several States unfairly taxes international corporations by restricting state taxation of non-U.S. income to that income effectively taxed by the Federal Government. Federal legislation to make this limitation clear to the States should be enacted.

EXPORT CONTROLS VERSUS RELIABLE SUPPLIERS

Another source of self imposed limits to competition deeply concerning CBEMA is U.S. policy in export restraints. CBEMA fully accepts that in this area of public policy legitimate issues can involve national security—concerns rightly paramount. But, despite improvements incorporated in 1979 legislation, the United States is still unique among all countries in its imposition of restrictive controls over its own exports. Barring or limiting our exporters in world markets for either domestic or foreign policy considerations often leaves us "odd man out," with consequent loss of sales, domestic employment and income.

Nor are short-term losses the only self-imposed handicaps. Loss of "presence" in a foreign market is often much more than a short-run consequence. Reliability and predictability of supply can be as important to the overseas purchaser of U.S. products as are reliability and predictability of treatment for a foreign investor, here or abroad.

Unilateral, often unpredictable, U.S. interventions into the outflow of goods and services raise serious long-run questions over the wisdom of developing and relying upon U.S. sources. Such concerns necessarily give our competitors an undue advantage: these concerns also lead to development of alternate sources. In a world of ever more diffused technology, and of more evenly matched economic capabilities, alternate sources exist for a steadily widening range of exportable goods and services.

To minimize these many adverse consequences, CBEMA strongly recommends: Stricter enforcement of the 1979 Export Administration Act's limitations on the use of export restraints for foreign policy purposes. These should be held to a minimum, seldom invoked; and U.S. exports of commercial goods, services and technologies should not be prohibited whenever alternative sources will surely replace U.S. exports.

THE FREE FLOW OF INFORMATION

The rapid expansion of international business and world-wide competition has also brought equally rapid growth in the flow of information across national borders. The daily conduct of business in this increasingly interdependent world has become critically based upon rapid access to information, wherever it originates. Both foreign trade and investment intertwine with expansion of data transmission and freely flowing exchanges.

Increased flow of information across national borders has brought parallel government efforts to exercise control and regulation, often misguided. Based partly on concerns for the privacy rights of individuals, controls potentially reach far afield.

These controls impair information flows essential to international business and to major U.S. interests, both users and suppliers. Encroaching controls and regulations threaten to become a major non-tariff barrier of the 1980's, especially in service industries where the United States is export competitive. With this prospect looming, CBEMA believes the U.S. Government should:

Develop a firm position opposed to controls over transborder data flow, with the exception of possible restraints for national security and personal privacy purposes.

Persuade other governments to limit restrictions based on privacy considerations to natural persons as distinct from "legal" persons.

Seek an effective international agreement with common criteria and enforcement on the flow of information, similar to the rules of conduct adopted in the MTN Codes for other Government practices. GATT should recognize unjustified restraints as a non-tariff barrier and bring them within its purview.

SUMMARY

The computer and business equipment industry's $5.9 billion trade surplus in 1980 reflects both its past emphasis upon technological improvement and its present competitive capabilities. It also shows deep commitment to world markets and the steady domestic growth and employment resulting from such a commitment.

At the same time, however, foreign competition for this industry grows rapidly, and technological differences narrow. Other countries, such as the European Community and Japan are determined to support and promote their own data and information processing industries. They recognize the potentials for their products, both for domestic uses and for expanding future exports. As in the past, with other industries, foreign governments provide preferential treatment and assistance to their growing and strongest industies.

For too long, in contrast, U.S. trade policy has been preoccupied with the dilemmas of its faltering and less competitive industries. While other governments focus on their strengths, the United States pursues solutions for our weaknesses, usually with, at best, dubious results.

CBEMA believes that the United States in the world of the 1980's must take a leaf from the same book, turning now to strategies to encourage its industries with proven capabilities in world competition.

BALANCE OF TRADE, U.S. COMPUTER AND BUSINESS EQUIPMENT INDUSTRY

[Dollars in billions]

	9 months 1981	Increase over 1980 (percent)	Estimated 1981 year end data	1980 year end data
Exports	$7.9	+19.1	$11	$8.8
Imports	2.6	+18.5	4+	2.97
Balance of trade	5.3	+19.3	7+	5.91

HUGHES HUBBARD & REED,
Washington, D.C., January 5, 1982.

RICHARD O. CUNNINGHAM, Esq.,
Steptoe & Johnson,
Washington, D.C.

DEAR DICK: Thank you so much for your courtesy in sending me a copy of your prepared testimony before the Trade Subcommittee of the House Ways and Means Committee. As always, it was clear and to the point. I cannot say I was persuaded by all of it!

A couple of observations on your statements (that I am taking the liberty of sending to Chairman Gibbons as well):

First, with respect to the "loophole" in the law enabling combinations of products to evade a dumping (or CVD) order: This is a problem not unique to the "tie-in" between electrical transformers and rectifiers. It arises in many guises: Does a dumping finding with respect to a certain chemical product apply to dilutions or strengthened versions or those with more or less active ingredients? Does a finding applicable to fibers of certain combinations and treatments apply to those with more or less treatments? To yarns? In connection with a speech I am preparing for delivery at Tulane University in March, some associates and I have been exploring this problem and it seems to be more complex and difficult than your example indicates. I do not think that it would be wise to jump too quickly with a "solution" until all of its implications are explored.

Second, if we are going to be concerned about the "evasion" of dumping orders by adding or subtracting ingredients, components or other characteristics, we ought no less to address the problem of what the Europeans are fond of calling "second generation dumping," i.e., the sale in the importing country of merchandise made from dumped (or subsidized?) materials. The case of fasteners made from steel the Japanese allegedly dumped in Korea is illustrative. Under present law, I doubt such fasteners could properly be made the subject of an antidumping order (assuming, of course, that the Korean fastener producers are not selling the fasteners below their own costs or appropriate "foreign market value" and are receiving no subsidies within the meaning of our law. I do not comment here whether the dumped steel would constitute a "private subsidy.")

Third, I do not think it is useful or constructive to label as "bizarre" or "phantasmagorical" the "simulated constructed value" rules that were developed at Treasury for dealing with imports from state-controlled economies under the antidumping law. On the contrary, as you know, the vast majority of commentators on these rules—who have not had clients with complaints against imports from such countries, to be sure—have viewed those rules as a reasonable way for dealing with a difficult problem. Indeed, the General Accounting Office, in its recent report on this subject, has recommended that the only way in which the Heinz bill would be fair and consistent with our international obligations to trading partners with "state-controlled economies" would be to add to the test that bill creates (and you endorse) the "simulated constructed value" test in the Treasury, now Commerce, regulation. The producers of Polish golf carts demonstrated that this procedure is workable; it is economically defensible; it produces a result on which a manufacturer and exporter in an SCE could reasonably rely in setting its prices; it is verifiable by existing techniques used by the Commerce Department and Customs Service; and it avoids what I regard is a ludicrous and often difficult task of looking to the actual prices or costs of "surrogate producers" in what may well be "bizarre" surrogate countries (such as Paraguay for the PRC).

Fourth, your remarks concerning the need for added staff at Commerce are right on target. Without additional personnel significant additional cases will overwhelm them. Your suggesting for ending interlocutory appeals to the CIT are also sensible.

The Court has, I believe, on its own adopted such a rule with respect to its reviews of §751 proceedings and that is a precedent Congress ought to follow with regard to the initial phases of the cases as well.

I will hope to be able to share with you in advance of our appearance before the Senate Trade Subcommittee in January what I propose to say on behalf of certain importers of products from Poland. However, from my remarks above you can properly anticipate that I will, in essence, be defending the GAO's recommendations and objecting to the "back door" elimination of injury tests for signatories to the GATT, much less the Antidumping Code.

Warmest good wishes to you for the new year.

Sincerely,

PETER D. EHRENHAFT.

KAISER CEMENT CORP.,
Oakland, Calif., March 16, 1982.

Hon. SAM M. GIBBONS,
Chairman, Subcommittee on Trade, Committee on Ways and Means, House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: Kaiser Cement Corporation, a U.S. cement producer since 1939 and currently the largest producer in the Western States, appreciates this opportunity to bring to the attention of the Subcommittee on Trade significant developments that are now occurring in a major industry sector—the cement industry. These developments are relevant to the subject matter of the Subcommittee's hearings and raise important issues with respect to the trade policy of the United States, which, to the best of our knowledge, have not yet been brought to the Subcommittee's attention. They affect the health and continued viability of an industry which provides an essential ingredient to at least 90 percent of all construction projects and which is, therefore, absolutely vital to the U.S. construction sector, which is itself the sixth largest industry sector in the United States.

Since at least the late 1950's, the United States cement industry has been the frequent target of dumped cement imports from a variety of foreign sources. In that period, 21 complaints were filed by the U.S. industry, most of them in the late 1950's and early 1960's, although the most recent was filed in 1977. In most of these cases sales at less than fair value were found, and in many of those instances the domestic industry was found to be injured or threatened with injury as a result of the dumped imports. A number of other cases were disposed of on the basis of administrative determinations and action that we believe would now be precluded by the revisions of the Antidumping Act adopted in the Trade Act of 1974 and the Trade Agreements Act of 1979.

One of the reasons for the large number of cases filed in the 50's and 60's was that during this period dumping was on a continuing basis, with importers shifting from country to country as complaints were filed against their sources of supply. In this period, there were formal proceedings involving cement imports from 15 different nations.

Portland cement has a low value-to-weight ratio, with the result that transportation is a significant factor in its delivered cost. Costs of transportation severely limit the distance from the producing site at which cement can be sold competitively at a profit, thus sharply localizing markets. The U.S. industry's experience with dumped imports in the past demonstrated to us, however, that some foreign cement producers have incentives to penetrate and exploit U.S. markets, and the ability to do so, so long as they can rely upon high prices in their domestic markets—and other foreign markets where they have little or no domestic competition—to subsidize their U.S. sales.

Recent developments in California have brought about a renewal of exports of foreign cement to the United States at dumping prices, in substantial volumes and in circumstances that make it uniquely serious.

Last year, two new terminals were opened at major ports in California, the express purpose of which is to serve as facilities for the receipt, storage and U.S. distribution of foreign Portland cement. In March, 1981, foreign cement began to be imported through a new cement terminal at the Port of Stockton, California, capable of handling at least 500,000 tons per year. A few months later, another new cement terminal—with an estimated annual throughput capacity of 600,000 tons—was completed at the Port of Long Beach, and importations commenced at once. At the Port of San Diego, an importer has been entering foreign cement since 1979 under a license to import 150,000 tons annually through that port's facilities. In addition, construction of still another terminal, with facilities capable of handling 500,000 tons of cement per year, is being studied by the Port Commissioners of the Port of Redwood City, California.

Together, these facilities will have the capacity to handle more than 1,750,000 tons of imported Portland cement annually. This potential volume is equivalent to more than 13 percent of the rate capacity of all California cement manufacturers, and almost 24 percent of the cement actually shipped in California last year.

The U.S. cement industry thus finds itself confronted, almost overnight, by a permanent establishment with a very substantial capacity, dedicated to the importation and sale of foreign cement in the California market. This is not a situation where imports are brought into a market to satisfy transitory conditions of excess demand caused by plant repairs, strike, or unusually high consumption. Let there be no mistake about it, the importers using these terminals have as their objective to capture a substantial, permanent share of the California cement market, a share that will persist in times of slack as well as high demand. That share can only be appropriated at the cost of U.S. producers located in that market, a cost manifested in lost profits, idled production, foregone plant renovations and construction, and lost jobs. But conversely, U.S. purchasers will not be able to rely on these imports as an always available source of supply, because they will be affected by developments in the foreign suppliers' other markets.

If the terminal imports succeed in capturing the permanent share of the market that the seek, it will be by dumping. Based on Kaiser's considerable experience in international markets, we know that is is virtually impossible for foreign producers to export cement to the United States at other than dumping prices. We are in the process of developing proof that the imports currently being made through the terminals are at less than fair value. However, preliminary indications strongly indicate that they are, and suggest dumping margins of up to more than 50 percent. In fact, during a recent six-month period, cement produced in Japan for export to the United States sold at an export net price of about $37.00 per metric ton, compared with about $60.00 per metric ton for the same quality cement sold for use in Japan during the same period.

These facts raise three important issues that I would like to bring to the Subcommittee's attention.

The first of these issues is whether or not current U.S. antidumping laws and procedures are adequate to assure that the imposition of sanction against dumped imports through these termainals will be swift and certain. We understand that speed and certainty were among the objectives sought by the Congress in enacting the Antidumping Act revisions incorporated in the Trade Act of 1974 and the Trade Agreements Act of 1979, and that as a consequence of those enactments there has been an improvement in administration of the antidumping provisions. We are concerned, however, by reports—like that given by SCM Corporation at the Subcommittee's December 16, 1981 hearing—of continued problems in the administration of the law, and by the "no injury" or "no reasonable indication of injury" determinations made by the U.S. International Trade Commission in the two most recent cement dumping cases.[1] We hope that the former represent aberrations, and that the latter are not indicative of a failure on the part of the Commission to evaluate accurately the U.S. cement industry's problems and its own obligation to apply the injury standards to the statute so as to achieve the basic objective of the antidumping law, which is to provide a sure and effective response to this kind of unfair international trade.

Our principal concern in this regard, however, is that the antidumping provisions be administered so as to provide an effective response to the kind of threat that the terminals which we have cataloged pose to the California cement industry. Because cement of a particular type is a fungible commodity and imports through the terminals will be sold in the same general geographical area, the imports through all of the terminals listed, from whatever foreign source, will have a cummulative adverse impact on the California cement industry. In addition, the possibility exists that if antidumping remedies are imposed with respect to imports from one foreign source, the importers concerned will simply and readily change their source of supply. This would necessitate new antidumping proceedings, even though the new imports again will have a cumulative effect, with those from other foreign sources that entered the market before them.

The Commerce Department and the U.S. International Trade Commission must recognize these facts and respond to them effectively and imaginatively. For example, these circumstances described clearly demonstrate that, in the event that antidumping proceedings are instituted, the U.S. International Trade Commission should be required to cumulate the less-than-fair-value imports from whatever different countries may be concerned, in determining injury. In addition, we recommend that means be adopted to ease the burden of U.S. industry in possibly having to prosecute a series of antidumping proceedings against several different foreign suppliers over a period of time. Self-initiated inquiries by the Commerce Department into the pricing practices of suppliers of foreign cement to the terminals and institution of a trigger price mechanism for cement might be one such means. Another might be periodic investigations and reports regarding the condition of the California cement industry and sales and pricing in its principal markets, by the U.S. International Trade Commission under Section 332 of the Tariff Act. In the absence of these or similar responses, the objectives of the antidumping provisions may be frustrated.

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[1] Issued in December 1976 (USITC Publication 795) and September 1978 (USITC Publication 918).

The second issue raised is whether the U.S. law, as presently constituted, is adequate to deal with a situation where, as appears to be the case here, the importers and foreign sellers concerned must know that they are dumping and yet proceed regardless of the damage that their activities will inflict on the U.S. industry. The fact that the firms concerned are engaged in such blatantly unfair conduct strongly suggests that in this respect our laws are not adequate. We cannot say whether this is because the pursuit of antidumping remedies is known to be time-consuming and expensive for the U.S. industry, because the ultimate application or non-application of those remedies remains somewhat unpredictable, because the penalty ultimately imposed when action is taken is not served, or because of some combination of these factors. We suspect, however, that if the penalty imposed for such obvious and intentional dumping, were greater, it would be ventured with less impunity. We therefore support the imposition of a treble damage penalty in appropriate circumstances, as envisioned by the bill (S. 432) introduced by Senator Mathias in the last Congress.

The third and final issue that we would like to bring to the Subcommittee's attention is the use by port authorities of their tax exempt status to subsidize the importation of foreign products in competition with domestic manufacturers. Examples of this inequitable practice include: (1) in the case of the proposed cement terminal at Redwood City, the port authority reportedly intends to finance a substantial portion of the variously estimated total cost of $8 to $24 million with tax-exempt revenue bonds; (2) although tax-exempt bonds apparently were not used for the Stockton and San Diego projects, we believe that these facilities were financed out of the tax-exempt operating revenues of these public port authorities; and (3) in the case of the Port of Long Beach, tax-exempt bonds were used to finance other projects, so that internally generated funds (also tax-exempt), were available to finance the cost of its bulk cement terminal.

The establishment of these import terminals is occurring at a time when the cement industry in California is operating substantially below full capacity, but is nonetheless spending hundreds of millions of dollars to modernize and expand its manufacturing facilities. Kaiser Cement alone has committed almost $250 million to improve the cost-efficiency, modernize and enlarge the capacity of its California plants. In 1981, the cement industry in California added nearly 1.7 million tons of annual capacity. By 1984, the industry is expected to add another 1.3 million tons of annual capacity. Nearly all of this new capacity will employ the most fuel-efficient technology available.

In general, we believe that the public interest is not served by permitting port authorities to use tax-exempt bonds or revenues to subsidize the importation of foreign products in competition with domestic manufacturer. Our reasons are as follows:

(1) It is patently unfair to provide foreign importers unlimited financing at below market rates for facilities to handle their products, when similar financing is not generally available to domestic manufacturers. Although it is desirable to promote international trade, this should be accomplished through the removal of artificial trade barriers, not through the creation of taxpayer-financed subsidies which accord foreign importers an unfair competitive advantage.

(2) To the extent that interest subsidies induce imports that would otherwise not be profitable, they cause an uneconomic allocation of capital resources. While ports and port communities may initially benefit from the resulting increase in trade, domestic manufacturers will suffer an immediate loss of sales and an eventual decline in investment and employment. As manufacturing plants are typically more capital and labor-intensive than import facilities, any loss of their natural markets to im-

ports will have a disproportionately adverse effect upon the domestic economy and particularly upon employment in those natural markets.

(3) The promotion of imports through interest subsidies undermines the President's program to stimulate business investment and improve productivity. Any artificial inducement for imports contributes to lower operating rates and returns on investment for domestic manufacturers. When domestic markets are over-supplied, the needed flow of capital funds into improved plant and equipment is likely to be retarded or inhibited.

(4) The substitution in the marketplace of subsidized imports for domestically manufactured products is likely to result in a net reduction in tax revenues. Because a portion of the profit on imported products typically is realized by foreign suppliers and shippers, the amount retained by the importer subject to tax in the U.S. can be modest, compared to that earned by a domestic manufacturer. Thus, in fact and effect, Federal taxpayer subsidization of import facilities is not being used for a legitimate public purpose. Rather, such use results in loss of domestic business revenues and a corresponding loss of tax revenue to the Federal and state governments.

(5) Although port facilities financed by tax-exempt bonds are required to be public in nature, they can be essentially single-purpose facilities for the exclusive use of an importer, because of design limitations or the lack of suitable alternative users. Such is the case with several of the cement import terminals referred to above.

Interest subsidies made available to foreign importers through port authorities are unfair and unnecessary to promote legitimate international trade. At worse, they enable marginally profitable importers to enter domestic markets as a result of their unfair advantage in obtaining supplies at dumping prices. The modest benefits obtained by a particular port and its local community do not adequately compensate for the long-term injury suffered by domestic manufacturers and the U.S. economy.

We recommend that Congress consider developing more explicit rules for assuring that tax-exempt financing can be used only for truly "public" import or export facilities. and rules that require the port authority to demonstrate that facilities so financed will not result in a loss of jobs in the community generally to be served by the imported products.

In conclusion, we would like to underscore that Kaiser Cement does not oppose rigorous and fair competition between domestic-produced and foreign-produced cement or other products. We do object, however, to unfair trade and the subsidization of foreign goods by the American taxpayer.

We respectfully request that this statement be included in the record of the Subcommittee's hearings.

Very truly yours,

WALTER E. OUSTERMAN, Jr.,
Chairman of the Board, President and Chief Executive Officer.

STATEMENT OF MOTOR VEHICLE MANUFACTURERS ASSOCIATION OF THE UNITED STATES, INC.

The issue of foreign trade-related performance requirements and the development of an appropriate United States policy response has attracted a good deal of attention in recent months. The Reagan Administration's July 8 policy statement on trade and the oversight hearings of this committee certainly indicate a concern over the implications for the United States economy of these performance requirements.

While some analysts define the issue in broad, non-sector specific terms, others have tended to concentrate their attention on foreign automotive trade-related requirements, with special reference to the policies of developing countries. This emphasis on the motor vehicle industry has led MVMA member companies to review their own experience with automotive trade and investment policies of nations around the world. This experience is extensive; our member companies[1] have been manufacturing abroad and trading in the international market for most of this century. The following comments are offered in the hope of contributing to a better understanding of these complex issues.

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[1] MVMA members include 11 U.S. automobile, truck, and bus manufacturers producing more than 99 percent of all domestic motor vehicles. MVMA members include: American Motors Corp.; Checker Motors Corp.; Chrysler Corp.; Ford Motor Co.; Freightliner Corp.; General Motors Corp.; International Harvester Co.; Mack Trucks, Inc., PACCAR Inc.; Volkswagen of America, Inc.; and White Motor Corp.

Before discussing automotive experience in detail, however, it would be useful to outline the general range of national programs that influence both trade and investment decisions, the apparent incidence of these programs in countries outside the United States, and which sectors they appear to influence. This overview will help to place in perspective the position of the automotive industry overseas with respect to national trade and investment related policies.

With regard to specific national policies that influence trade and investment, much attention recently has focused on trade-related performance requirements that fall into two general categories: (1) export requirements, and (2) local content requirements. Export performance requirements usually are commitments imposed on an investing firm to export a certain percentage of production or to offset their imports with exports, while local content requirements generally specify that a given proportion of the final output must be obtained from local sources or produced locally by the foreign investor.

These performance requirements generally occur in combination with other government policies that limit imports of similar products into the host country. Such import limiting policies might include high—often prohibitive—tariffs, various types of tax and other non-tariff barriers that discriminate against imports, limitations on foreign exchange available for imports, or other forms of restrictions such as quotas. In order to stimulate domestic production of the import-limited product, tariff concessions which often reduce or waive the high rates imposed on selected imports are given to firms that make the desired investments in local production. Other industrial policies may provide for tax rebates applicable variously to local sales, or to export sales of items produced in the host country, or to the investment required to accomplish local production. Additional forms of industrial policy may include modification or waiver of limitations on foreign ownership, more liberal terms for remittance of dividends, concessionary credit facilities, duty free importation of machinery and equipment, etc. Moreover, many of these national policies can be informal or shaped to fit the circumstances of individual investment programs approved by the host government.

As to the incidence of such national programs, the recently published benchmark survey[2] by the Department of Commerce provides some useful data on the frequency and type of programs encountered by U.S. firms with affiliates operating overseas in 1977. There are limitations to the data, of course; for example, the survey applies only to one year for those countries and sectors where U.S. affiliates had chosen to operate. Nevertheless, the survey indicates where such programs are prevalent and which sectors appear to be affected.

The frequency with which U.S. affiliates reported incidents of trade-related industrial policies in developed and developing countries is summarized in Exhibit I. Although incidence of performance requirements tends to be higher in developing countries than in developed countries, the proportions are low for both groups. Moreover, the range in frequency of other trade-related industrial policies of the developed countries rivals those of developing countries.

The survey includes affiliates in mining, petroleum, trade finance and services, as well as manufacturing. The proportion of performance requirements in manufacturing tends to be higher than average. Within the manufacturing sector, the pattern of variation for transportation equipment—predominantly motor vehicles—is similar to other major sectors such as electrical equipment, food processing, chemicals, and nonelectrical machinery (Exhibit II). Transportation equipment does appear to be somewhat above-average with respect to local content requirements, but these requirements apparently exist in most of the major manufacturing industries.

These data do not measure differences in the magnitude of performance requirements among industries and sectors, nor do they provide any basis for evaluating the relative impact of such national policies on U.S. investment, trade and employment. They do suggest, however, that such policies are not unique to developing countries and certainly are not unique to the motor vehicle industry. Consequently, it appears desirable to consider all aspects of these trade and investment-related issues wherever they occur and not simply to focus on sector-specific policies in certain countries.

Trade and investment-related policies obviously may cause distortions in internatinal trade and investment flows, but far too little is known about the scope of these policies and their actual impact on the international economy. In the absence of comprehensive information and analysis of these questions, the conclusion offered by some commentators that such requirements exercise a pervasive influence on international investment patterns and substantially distort international flows of trade and capital is unwarranted. Performance requirements together with other import substitution policies may lead in the long run to the creation of internationallly competitive industries. In these cases, the cost of temporary distortions in international trade and investment flows may be justified by long run improvements in international efficiency and welfare. In other cases, there may not be much chance for eventual international competitiveness, and these temporary distortions may have doubtful justification. Consequently, we are pleased that U.S. international economic policymakers recognize the limited state of knowledge of these subjects and have urged international fact-finding and discussion through the GATT Secretariat and the OECD Committee on International Investment and Multinational Enterprises (CIME) as the first step in developing U.S. policy alternatives.

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[2] U.S. Direct Investment Abroad, 1977, U.S. Department of Commerce, April 1981.

MOTOR VEHICLE SECTOR

Although the motor vehicle sector is not unique in being the object of national development policies around the world, the industry does play a vital role in many national economies and for this reason it probably has felt the effects of such policies earlier than many other manufacturing sectors. Consequently, we are happy to share the experience of our member companies with these policies in the interest of contributing to better understanding of the issues and policy options.

Our companies' international experience causes us to disagree with the conventional wisdom of the current discussion that performance requirements and other import substitution industrialization policies are universally misguided attempts 1) to shape economic objectives through government fiat and 2) to circumvent internationally accepted rules against discriminatory trade barriers. The success of some countries in attracting the required investment levels for their import substitution strategies seems to confirm the soundness of their import substitution approach. In these cases, the creation of an internationally competitive manufacturing sector is a viable long run objective that may well be worth the temporary costs incurred. In other countries where the import substitution strategy is not considered to be viable in the long run, individual manufacturers have chosen not to participate or even to disinvest.

MVMA member companies believe that market forces rather than government policies should determine what type of products are built, where they are produced, and the prices at which they are sold. In addition to this general commitmant, however, our members recognize that national or regional economic policies may call for industrial growth through planned programs for the motor vehicle and other industrial sectors. In these cases, governments and consumers generally pay a higher cost for vehicles to support the development of human resources and local infrastructure. When this approach is adopted, we recommend that governments mandate only overall objectives, allowing individual manufacturers to determine how those broad objectives should be attained. Any country desiring to establish a domestic motor vehicle industry also should be aware of the aforementioned costs to the economy and not merely the benefits received. An assembly manufacturing industry created through temporary import substitution and performance requirement policies may be more costly and less efficient than importing vehicles from the world market. These costs should be weighed against potential benefits that accrue to the country at large over the longer term.

Outside the United States, national policies to promote the development and growth of domestic motor vehicle industries have been present almost from the beginning in what are known today as the developed countries. The creation of a motor vehicle industry has been and continues to be a key element in the industrialization plans of many of these countries. This assignment of the motor vehicle industry to such a central role in national development is the result of the widespread belief that the creation of an automobile/truck manufacturing industry helps achieve vital economic and industrial development goals.

The specific approaches taken by individual countries in their attempts to create a domestic motor vehicle industry have varied with the circumstances of each country. In the case of Western Europe, the largest automotive market in the world outside the United States, the national policy approach of the early 1900's was mainly to limit imports through high tariffs, discriminatory taxes, and other non-tariff barriers. In most cases, foreign investment in local auto production was accepted and often encouraged. Although tariffs have been reduced in recent years, the EC's external tariff on motor vehicles today, for example, is still substantially higher than the U.S. rate structure. Most of the other policy elements continue in effect or have been augmented.

Japan today represents the third largest domestic auto market but for most of the post-war period was comparable to a developing country, following far more stringent trade and investment policies. Until 1971, tariff and taxation rates on imported vehicles were quite high and foreign investment in local motor vehicle production was excluded altogether. These policies were, for the most part, as severe as any of the policies pursued by developing countries today.

Other developed countries faced somewhat different problems than Europe and Japan in developing local motor vehicle industries. Their national markets were smaller and import limitations alone were often supplemented by other policies to encourage investment in local automotive production. Canada experimented with a duty remission program which precipitated a major trade dispute with the United States. The conflict was resolved by the negotiation of the U.S.-Canadian Automotive Products Trade Agreement which established duty-free trade between the two countries for most automotive products. In implementing the agreement, however, Canada established several performance requirements to assure the maintenance of a certain level of local automotive production and/or exports. Australia, New Zealand and South Africa initially relied upon local content requirements in combination with severe import restrictions to foster a domestic automotive industry. Over time these requirements were modified in most cases to incorporate provisions to substitute increased exports to obtain better economies of scale.

With this record before them, it is not surprising that many developing countries have chosen to make domestic automotive production a key national development objective. Typically, a development country first will institute measures to restrict imports of fully assembled motor vehicles and offer a series of incentives that have the net effect of encouraging foreign firms to establish vehicle assembly facilities in the country. The policy measures employed to achieve these objectives include a combination of: (1) assistance to attract foreign investment plus (2) barriers that inhibit imports of fully assembled motor vehicles such as license requirements, tariffs, foreign exchange deposit requirements, and quotas. In order that the newly established domestic industry not become a major consumer of foreign exchange for imported components, the country might next proceed to promulgate policies establishing escalating requirements for the proportion of component parts of the vehicle which must be manufactured locally. These policies are not intended principally as elements of a country's international economic policy but as vital domestic policy tools in the nation's overall approach to industrial and economic development.

Brazil and Argentina began this process in the late 1950's with an objective of essentially full substitution of domestic auto production for imports of motor vehicles and their component parts. Since then, most developing countries of any significant size have embarked on similar programs, although most have avoided complete import substitution because the cost of such motor vehicle production in markets of relatively low volume rises disproportionately as the proportion of local content increases.

Although motor vehicles produced in a local automotive industry composed of relatively low volume vehicle assembly and selected component manufacture may be more costly than vehicles imported from the world market, some host countries do not consider this comparison to be relevant to decision-making. Instead, the decisions appear to rest on evaluations of what it would cost the country to obtain the same magnitude of benefits in jobs, production, national income, and foreign exchange by other means. Often, such other means do not appear to exist at any cost. Thus, our companies repeatedly have experienced the futulity of attempting to dissuade some countries from embarking on such programs because of cost penalties. Such comparisons have been rejected as meaningless if the alternative is to give up what amounts to a fundamental element of national development policy.

Because of their impact on the domestic and international economy, countries should keep these broad performance objectives under constant review in light of their changing development needs. The governments of Australia, Chile, Peru and to some extent Argentina are illustrative of countries that found the cost of their policies too high and revised in varying degree their efforts to develop a motor vehicle industry through the use of import substitution policy tools. These four countries also illustrate the current inclination of many countries to reassess their experience with import substitution industrialization strategies. On the other hand, the past success of Japan serves as an example of a country paying the temporary costs of developing an infant industry in exchange for longer run improvements in both domestic and international efficiency and welfare.

Governments have turned increasingly to approaches that would accomplish their national goals but still avoid excessive cost penalties by encouraging greater scale production of fewer components through export programs. Japan's success in targeting export products certainly has played a role in this change, particularly in the Far East. By raising exports of certain automotive components—and also by increasing imports of other automotive components or vehicles—the same national goals can be accomplished at lower cost. This means lower domestic prices for cars and trucks than otherwise would be obtained and thus more domestic volume. It frequently also means more modern production because of the flexibility to import selectively.

As far as the United States is concerned, such programs may offer substantially more opportunities to export automotive components and parts than would be possible with more sweeping import substitution programs. This is true from a static analysis of the present situation as well as from a more dynamic, long run perspective that considers the expanded potential for automotive sales growth—including aftermarket parts—in the developing country. The experience of U.S. manufacturers with recent Mexican automotive policies offers support for this proposition. It is important that these positive aspects be fully evaluated before final conclusions are made with respect to the overall trade effects of export requirements.

Very large automotive investments have been made by U.S. motor vehicle manufacturers to develop the sales potential of overseas markets. According to the benchmark survey, the assets of foreign affiliates of U.S. motor vehicle and equipment firms in 1977 amounted to more than $34 billion. The benchmark survey also indicates that U.S. motor vehicle and component firms exported more than 15½ billion in automotive goods in 1977. These same firms imported $12 billion of goods in return. These data do not include many export sales by U.S. suppliers of original equipment and aftermarket parts that do not have foreign affiliates nor do they count the $1½ billion in earnings of foreign affiliates of U.S. motor vehicle and equipment producers.

Overseas automotive investments do not occur merely because of the presence of investment incentives and performance requirements. Fundamental economic factors play an important role as well. Sourcing decisions are substantially influenced by the advantages derived from production utilizing economies of scale and from the efficiencies generated by responding to differences in manufacturing costs among national economies. Ideally, production of automotive components, whether by subsidiaries of vehicle assemblers or by independent producers, is undertaken in facilities designed to operate at the most efficient scale of production. Such production is not intended necessarily just to meet the demands of the market in which the facility is located; in planning the facility, global requirements for its output often are the operative factors. Thus, the integrated production of a major component, shock absorbers, in a world scale plant located in the United States is used to satisfy both the U.S. and European vehicle assembly operations of a major U.S. producer. Similar optimal scale plants are in operation or are planned by all major vehicle and component manufacturers.

Differing factor endowments among countries also produce real differences in manufacturing costs. Evaluating the various costs of raw materials, energy, labor, transportation, capital, technology, and other factors makes this decision-making process extremely complicated. Some of the more obvious conclusions from this process, for example, are that the sourcing for weight-reducing aluminum components will likely come from resource and energy abundant locations; for high volume, labor-intensive electrical and electronic components, like wiring harnesses, from labor abundant locations; and for technologically sophisticated components, like computerized engine controls or catalytic converters, from capital and technology abundant locations. Detailed cost of production computations are basic to this process.

Sourcing decisions, however, are also influenced by factors that have elements of both an economic and a non-economic nature. Companies may decide on a particular source for components to diversify their supply and thereby reduce vulnerability to supply interruptions. Such diversification can also provide greater financial security by hedging against exchange rate changes. A manufacturer with significant liabilities in a particular foreign currency may wish to offset them through establishing manufacturing facilities that generate assets in that currency.

Purely non-economic factors are also essential considerations in this process. An area of growing importance is political risk assessment—the potential of a given area for social, political and regulatory stability and its attendant impact on business operations.

And finally, the entire spectrum of governmental economic policies must be considered. These include not only specific performance requirements but also macroeconomic policies, trade policies, general and sectoral development policies, competition policies, research and development, government purchasing, manpower, and energy and natural resources policies. Not all of course may need to be addressed in each sourcing decision, but a general appreciation for the overall impact of the role of government on a potential sourcing arrangement must be factored into the decision-making process.

Thus, international trade in automotive products and the choice of location for production are the result of many complex factors, some of which are influenced by, but certainly are by no means dictated by the existence of investment incentives and performance requirements overseas.

It is also useful to place the foreign sourcing of automotive parts for U.S. manufactured vehicles into perspective. At present, well over 90 percent of the value of the fleet of U.S. and Canadian manufactured vehicles is procured from sources in these two countries—mainly in the United States. While the impact of foreign incentives and performance practices on sourcing of automotive parts for U.S. manufactured vehicles should not be ignored, the competitive strength and vitality of U.S. automotive producers seems likely to have far more impact on U.S. economic and employment prospects than will the overall effect of the industry's response to trade and investment-related policies.

CONSIDERATION FOR UNITED STATES POLICY

The United States Government has placed the issue of trade-related investment performance requirements on its trade policy agenda. Recognizing the absence of analytical work on the impact of these foreign policies on the U.S. economy, the initial step quite properly has been to request background studies on the subject from the GATT Secretariat and the OECD. We are supportive of these international fact-finding and analytical efforts. As more is learned about the impact of these policies and practices, an international consensus may develop on the need for new international rules. Indeed, the close relationship between the domestic development policies of so many countries and investment and trade-related practices requires such a consensus before attempting to alter these practices. Thus, we support broadly based international approaches to these issues. The issue of foreign performance requirements is clearly not an automotive or developing country issue. Rather it is multilateral and multi-product in scope.

With respect to the motor vehicle sector, we urge that U.S. policymakers recognize that investment and trade-related practices almost always are directly tied to domestic policy goals considered to be vital by most countries overseas. Because of this relationship, these practices are deeply imbedded and politically sensitive. Although the form of some foreign practices has become more sophisticated in recent years, the objectives they seek to accomplish are neither new nor novel.

Furthermore, the United States does not have a monopoly on motor vehicle producers willing and able to adapt their overseas operations to accommodate the national priorities of our trading partners. And, in the few cases where automotive performance requirements have been liberalized—for example, in Chile, Peru, Singapore, and to some extent in Argentina—the gains from increased passenger car trade have not accrued to U.S. exporters.

In the absence of a multilateral consensus on how to address performance requirements, MVMA recognizes that the issue might occasionally manifest itself in a bilateral sector-specific fashion. In these instances, each case should be evaluated by the U.S. Government with a view not only of assessing the nature of the foreign automotive practice at issue and its real effects, but equally important, of the impact of the practice and the proposed U.S. policy response on the overall international competitiveness of U.S. industry. Analysis should not focus on domestic production and employment considerations alone. Moreover, full consideration should be given to the risk that, if the United States attempts, but then fails, to induce individual countries to lower performance requirements, subsequent bilateral trade tensions might jeopardize the international competitive position of the U.S. auto industry and other vital sectors of the U.S. economy.

CONCLUSION

It is our hope that these comments have contributed to the public discussion of the issue of foreign performance requirements and U.S. policy. MVMA is supportive of the general view that performance requirements may cause distortions in international trade and investment flows. Where an underlying economic potential exists, however, global welfare and efficiency may well be enhanced in the long run as a result of temporary policies that create short-term distortions in trade and investment flows. Because of this uncertainty over the significance of the trade-related performance requirements issue, we believe that much remains to be learned before the actual international or United States impact can be assessed.

EXHIBIT I

U.S.-OWNED OVERSEAS AFFILIATES AFFECTED BY TRADE-RELATED INDUSTRIAL POLICIES BY COUNTRY

[In percent]

	Developed (OECD) countries				
	Canada	Europe	Japan	Australia/other	Total
Type of industrial policy:					
Tax	14	20	8	34	19
Tariff	5	4	3	14	5
Subsidies	6	14	1	10	11
Export minimum	(¹)	1	0	1	1
Import limit	1	1	1	4	1
Local content	1	1	1	2	1
Local labor	2	4	2	3	3
Other	4	5	2	10	5
Number of affiliates (thousands)	3.3	9.9	.9	1.5	15.6

	Developing countries				
	Latin America	Africa	Middle East	Asia Pacific	Total
Type of industrial policy:					
Tax	24	15	19	20	22
Tariff	15	15	12	13	14
Subsidies	5	2	7	3	5
Export minimum	2	1	4	5	3
Import limit	5	7	2	²6	²5
Local content	6	4	3	²5	²6
Local labor	20	25	13	11	18
Other	5	6	6	5	5
Number of affiliates (thousands)	4.8	.7	.5	1.6	7.6

[1] Negligible.
[2] Partially estimated.

Source: U.S. Direct Investment Abroad, 1977, U.S. Department of Commerce, April 1981.

EXHIBIT II

U.S.-OWNED OVERSEAS AFFILIATES AFFECTED BY TRADE-RELATED INDUSTRIAL POLICIES BY INDUSTRY

[In percent]

	Major industrial sectors					
	Mining	Petroleum	Trade/finance	Services/other	Manufacturing	Total
Type of industrial policy:						
Tax	24	13	11	11	31	20
Tariff	12	8	3	3	14	8
Subsidies	5	5	3	3	16	9
Export minimum	3	5	(¹)	(¹)	3	2
Import limit	3	2	1	1	4	2

U.S.-OWNED OVERSEAS AFFILIATES AFFECTED BY TRADE-RELATED INDUSTRIAL POLICIES BY INDUSTRY—Continued

[In percent]

	Major industrial sectors					
	Mining	Petroleum	Trade/finance	Services/other	Manufacturing	Total
Local content	4	3	1	1	4	3
Local labor	15	13	5	6	10	8
Other	8	4	2	2	9	5
Number of affiliates (thousands)	.3	1.9	8.1	3.6	9.7	23.6

	Selected manufacturing sectors					
	Electric/ electronic	Transportation equipment	Food products	Chemicals	Metal fabricating	Nonelectric machinery
Type of industrial policy:						
Tax	37	34	35	33	31	28
Tariff	21	18	13	16	11	11
Subsidies	18	16	16	16	18	15
Export minimum	5	5	2	2	2	3
Import limit	4	6	5	4	5	4
Local content	5	13	4	3	5	5
Local labor	13	12	12	10	9	7
Other	11	11	7	9	8	10
Number of affiliates (thousands)	.5	1.0	.8	2.3	1.1	1.3

[1] Negligible.

Source: U.S. Direct Investment Abroad, 1977, U.S. Department of Commerce, April 1981.

STATEMENT OF NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION

I. INTRODUCTION

The National Machine Tool Builders' Association (NMTBA) is a national trade association representing over 400 American machine tool manufacturing companies, which account for approximately 90 percent of United States machine tool production. Although the total machine tool industry employs approximately 90,000 people with a combined annual output of around four billion dollars, most NMTBA member companies are small businesses with payrolls of 250 or fewer employees.

While relatively small by some corporate standards, American machine tool builders comprise a very fundamental segment of the U.S. industrial capacity and have a tremendous impact on America. Our industry builds the machines that are the foundation of the United States' industrial strength and military might. Without metal cutting and forming equipment—machine tools—there would be no manufacturing as we know and have come to rely upon today. From a consumer point of view, modern machine tools enable domestically affordable and internationally competitive luxuries of modern life. And even more importantly, without state-of-the-art technology our defense industrial base would be dangerously less capable of meeting the needs of national defense in peace time, much less responding to the demands of increased military production in a time of national emergency.

With this background in mind, we thank you for once again giving us the opportunity to express our views on the vitally important subject of international trade.

II. THE UNITED STATES NEEDS AN EFFECTIVE AND COMPREHENSIVE TRADE POLICY, BECAUSE INTERNATIONAL TRADE IS A VITAL ELEMENT IN OVERALL ECONOMIC PERFORMANCE

The importance of international trade to our overall national economy is often underestimated. In an economy which has until only recently been primarily oriented to the domestic market, it is understandable why such a misapprehension exists. However, policies based upon such a misconception act as seriously debilitating forces in the overall mechanics of our Nation's economy. For example, recent studies have suggested that the current recession is at least in part related to the decline in our export competitiveness.

The increasing importance of international trade to the U.S. economy is evident from statistics comparing exports as a percentage of national output. In 1972 the ratio of exports to Gross National Product (GNP) was 6.2 percent. In comparison, by the third quarter of 1981 this ratio had grown to 12.3 percent. However, these statistics reflect only one side of the balance of trade equation. Although the volume of U.S. exports has increased substantially over the past decade, this growth has been more than negated by rapidly expanding imports, the result of which has been an aggregate merchandise trade deficit over the past five years exceeding $120 billion. Were is not for service trade surpluses accrued during these years, it would have been impossible to have maintained a balanced current account (merchandise and service trade) during this period.

Unfortunately, what we are now experiencing is a slowing or perhaps more accurately a stabilizing of U.S. export performance simultaneous with a significant increase in imports. The consequence of this, barring major currency fluctuations, is the distinct possibility that our current account will also be in deficit by the end of fiscal 1982, if not sooner.

Narrowing our focus to just our own industry, it is important to point out that while the domestic U.S. machine tool market has been oscillating with very little real growth since the middle 1960's, the world market has grown substantially. Unfortunately, most of this worldwide expansion has been absorbed by our foreign competitors, eroding our market share.

In the middle 1960's, the American machine tool industry supplied approximately one-third of the total global market. In other words, one out of every three machine tools consumed in the world was produced by an American machine tool builder. However, according to recent statistics, as of the end of 1980 that portion had fallen to only 17.7 percent. In short, over the past 13 years, our share of the world market and plummeted by almost 50 percent.

This dramatic decline is the result of two factors: (1) an invasion of the U.S. domestic market by foreign competitors, and (2) a dramatic decline in U.S. builders' share of the export market.

Since 1964 American imports of machine tools have more than quadrupled, from 7 percent of total consumption 16 years ago, to almost 30 percent this year. The machine tool industry's balance of trade was negative for the first time in history in 1978. In 1979 it was in deficit by $400 million and by $513 million in 1980 (see Figure No. 1).

For the first eight months of 1981 the trade deficit was $235 million. Annualized, this would indicate that our industry will suffer its fourth straight year of negative trade balance, with a deficit of approximately $350 million. Although on the surface this may suggest an improvement over the past two years' performance, a closer look indicates that while export sales (not orders) improved somewhat (a phenomenon upon which we will elaborate below) during 1981, imports also continued to increase from $1.3 billion in 1980 to an estimated $1.5 billion for 1981.

In short, it is obvious that because the United States is the largest open machine tool market in the world, our foreign competitors have pulled out all the stops and are aiming their export marketing efforts directly at America. While the plight of the American automotive industry is obvious to anyone who observes the number of foreign imports on our highways these days, it is a much less known fact that the machine tools found in U.S. factories which produce cars and other metal products are also increasingly of foreign origin.

Statistically speaking, our industry faces as great if not a greater challenge from imports than do the automakers in Detroit. Moreover, from the standpoint of national defense, a strong and modern machine tool industry, which is so important to the well-being of our economy, is also critical to the maintenance of our military preparedness—that is, the ability of America's industrial base to meet the needs of national security during peaceful times, and to respond to the demands of military production in a time of national emergency. For an excellent in-depth study of this issue we would refer this Committee to the December 31, 1980, report of the Defense Industrial Base Panel of the House Committee on Armed Services.[1] This report points out the alarming shortcomings of our present defense industrial base.

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[1] U.S. Congress, House, Committee on Armed Services, "*Air Force Systems Command Statement on Defense Industrial Base Issues,*" by Gen. Alton D. Slay, Commander, Air Force Systems Command, before the Industrial Preparedness Panel of the Committee on Armed Services, House of Representatives, 96th Cong., 2d sess., 1980, p. IV-2.

A finer resolution of these aggregate trade statistics reveals that one out of every nine dollars spent by American industry on machine tools is being spent on Japanese equipment. Import sales in our domestic market are not a new phenomenon. As figure No. 2 shows, the first wave of imports came during the mid 1960's, when import market share increased from about 7.5 percent to 12 percent. However, Figure No. 3 clearly illustrates the dramatic jump in the value of foreign machines sold in the United States that has occurred in the last three years. As you might have guessed, the value of Japan's machine tool shipments to the United States increased during this period (both in terms of actual dollar value and in terms of relative market-share), more than quadrupling since 1977.

Clearly, the Japanese have targeted the United States machine tool market. This fact becomes quite evident when we examine the statistics detailing Japan's top ten machine tool markets for the years 1975 and 1980. (See Exhibit No. 1)

In 1975, the United States market accounted for 20 percent of all machine tools exported from Japan. Even at this point American purchases comprised the single largest export market for Japanese machine tool builders, with the Republic of Korea a distant second at 13.3 percent.

By 1980, almost four out of every ten machine tools exported from Japan were destined for American buyers. This represents a doubling of the share of Japanese machine tool exports being sold in the United States. This amounted to close to five times the volume sold to West Germany, the second largest Japanese foreign market in 1980.

While the Japanese share of the United States domestic machine tool market more than tripled from 1975 to 1980, the dollar value of Japanese exports into this country ballooned more than ten fold, from $47.4. million to over $492 million (10.9 percent of the U.S. market). And if these statistics are not alarming enough, annualized data for the first eight months of this year indicate a Japanese import total of approximately $660 million (14.0 percent of the U.S. market). A nearly 33 percent increase over 1980's record high.

Finally, we should not fail to appreciate the types of machines that are being supplied to domestic manufacturers by our Japanese competitors.

Lathes and milling machines continue to constitute the largest proportion of imports. However, imports of grinding and polishing machines, gear-making machines and metalforming machines have all more than doubled in the last three and one-half years. But perhaps most significantly, machining center imports have dramatically increased over the past several years to where they totaled more than $119 million in 1980.

In sum, we are losing an increasingly larger share of our domestic machine tool market to Japanese imports each year. But perhaps even more distressing is the changing character of that market share. It is increasingly comprised of more technologically advanced equipment (See Figure No. 4). In 1980 almost three-quarters of the Japanese metal cutting machine exports to the U.S. consisted of equipment with sophisticated numerical controls. Perhaps this could have been expected since the United States economy is the largest free market in the world. However, it is certainly a development to which we can ill-afford to resign ourselves.

Our industrial base is becoming dependent upon foreign sources. During periods of mobilization in a national emergency this foreign source dependence could cause severe production problems and could seriously threaten our national security.

But imports are only one aspect of the machine tool industry's international trade difficulties. We caution that we should not become falsely encouraged by the increased dollar value of U.S. exports in recent years. If we look at American exports as a percentage of all machine tool exports in the world, the statistics are indeed alarming. We have been losing export market share at a dramatic rate.

Our share of the world's machine tool exports fell by two-thirds from 21 percent in 1964 to just 7 percent last year, placing us well behind West Germany and Japan as a machine tool exporting nation.

As we noted above, 1978 marked the first time in history that the United States suffered a machine tool trade deficit, with imports exceeding exports by $155 million. And even though U.S. machine tool exports in 1980 grew by more than 40 percent over 1978 levels, imports soared by more than 80 percent to produce a trade deficit of over $500 million for the year. The trend is apparent and shows no sign of subsiding. Statistics for the first eight months of 1981, when annualized, indicate that the volume of imports will rise to approximately $1.5 billion, the highest single year import total ever recorded. Compounding the severeity of this problem is the fact that new machine tool orders received by U.S. builders during 1981 are more than 40 percent below 1980 levels.

Of course we recognize that the substantial strengthening of the dollar on international markets which has occurred over the past year has been a major factor in the trade balance we face. However, this is obviously not a development that we should complain about, because it is precisely what is needed to demonstrate a strong U.S. economy and a first step in dealing with the bigger and more debilitating problem of inflation.

We must take the actions that are necessary to make the machine tool industry more competitive in the world marketplace. This is a national security necessity because we cannot be dependent on foreign machine tools any more than we can be dependent on foreign weapons.

The causes for the United States' decline in international competitiveness are numerous. These difficulties can be explained both in terms of certain practices of some of our trade competitors, as well as by self-imposed laws and regulations which, although well-intended, have oftened served to put American businessmen at great disadvantage vis-a-vis their foreign counterparts. The following comments will examine some of these issues.

III. UNFAIR AND PREDATORY TRADE PRACTICES SERIOUSLY UNDERMINE THE STABILITY OF THE INTERNATIONAL ECONOMIC ORDER

We completely agree with the sentiment expressed by many of the Administration witnesses earlier in these hearings, that if we are to fully realize the benefit of open trade, and if the global trading system is to be successful in efficiently allocating resources on a worldwide scale, international trade must reflect natural competitive advantage and not government manipulation of the conditions of exchange.

A. Government subsidized export financing of certain nations has led to distortions in international markets

Unfortunately some governments have increasingly compensated for non-competitive exports or have attempted to give their exporters a marketing advantage through heavy subsidization of targeted industries, thereby enabling these industries to assume strengths they would not otherwise possess.

Clearly, such subsidies inhibit the normal competitive forces in the international market place. As a result, U.S. companies have frequently lost sales to foreign competitors, both at home and abroad.

Often, members of our industry have competed for foreign sales, equalling or surpassing their competitors, only to lose the order at the point where financing arrangements become a factor.

Although such practices may benefit some countries' trade balances in the near term, the long range effect is costly and inefficient for all members of the international community. For example, in 1980 alone, the annual cost of interest rate subsidies paid by major trading nations is estimated to have been at least $5.5 billion.[2]

NMTBA believes that export financing should be a neutral element in international trade competition, and we strongly support the U.S. government's attempts to reduce and ultimately eliminate such export credit subsidies. The recent informal arrangement limiting aircraft financing interest rates to 12% is a step in the right direction, but much more needs to be done.

However, while these reductions are being negotiated NMTBA believes that U.S. authorities should strengthen export promotion and financing programs which afford U.S. business the flexibility to match subsidized financing of predatory foreign governments. To do otherwise is to unilaterally disarm and to foster economic stagnation and unemployment while our foreign competitors gobble up export markets through predatory financing and other practices.

U.S. industry and our trading partners must know that the U.S. government is prepared to act, using such available remedies as are appropriate to the particular circumstances, to assure that American goods are fairly traded in international markets.

B. Certain U.S. trade policies and statutory requirements act as self-imposed impediments to exporting

In addition to the trade barriers erected by our competitors, American businessmen are also confronted by a wide and frequently confusing array of U.S. trade policies and regulations. Often such well-intended policies have an unforeseen and detrimental impact on U.S. companies. In an effort to ensure that American businessmen set the highest ethical example, we have enacted laws and created administrative bureaucracies to enforce compliance with these high standards. While we certainly agree with the appropriateness and indeed the necessity for honest and forthcoming behavior in business, we fear that too often our legislative and government officials lose sight of the fact that other societies and cultures are not like our own. What would be considered less than totally "proper" practice on our shores is "business as usual" in other markets. In essence, what we are saying is that we must be realistic in our assessment of the international environment in which U.S. business must compete. We cannot continue to put our own businessmen at a disadvantage before they even enter the arena.

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[2] It is estimated that France alone provides $2.3 billion of such subsidies, the United Kingdom $1 billion, Japan $566 million, and the United States $315 million. See, U.S. Congress, House, Committee on Ways and Means, statement of Hon. William E. Brock, U.S. Trade Representative, Oct. 28, 1981, before the Subcommittee on Trade, Committee on Ways and Means, House of Representatives, during hearings on U.S. Trade Policy, 97th Cong. 1st ses., 1981.

Going one step further, we also hear of cases where U.S. firms have been successful in meeting the challenge of foreign competitors and overcoming the additional burden of U.S. imposed trade regulations only to ultimately lose orders because of lack of competitive export financing.

For example, consider the recent experience of one of our members. This Pennsylvania based machine tool builder, a company which employs over 10 percent of the total population of the town in which it is located, was disappointed to learn that its application for an Exim Bank loan had been denied. According to Exim Bank officials, the loan for the financing of this sale had been turned down because the product to be manufactured on the machine would be shipped into the United States. We would state for the record today, as our member has already expressed to Exim Bank officials, that the product to be manufactured in Mexico will be shipped into the United States regardless of where the machines upon which it is produced are purchased. The actions of the Exim Bank Board in this case have not prevented imports from coming into this country, they have simply prevented a U.S. company from being internationally competitive enough to make what would be a substantial foreign sale.

Although we fully understand the limitations within which Exim Bank must operate in these times of budgetary constraints, we do not believe that U.S. business should lose sales, and ultimately U.S. workers should lose jobs, based on trade policies as ineffective and counter-productive as those which were the basis for the denial of the Exim Bank loan in the above case.

Having identified the problems and briefly explained how they are impacting the U.S. machine tool industry, we now turn to several specific issue areas which we believe may offer at least part of the solution to these problems.

IV. CONGRESS AND THE ADMINISTRATION SHOULD ACT EXPEDITIOUSLY IN ASSISTING U.S. BUSINESS MEET THE CHALLENGE OF INTERNATIONAL TRADE

A. Export Trading Co. legislation (ETC)

Export Trading Co. legislation (S. 734) unanimously passed the Senate last April, and we commend that body for developing and expeditiously passing legislation which by its design will spur creation of large scale American trading companies that would provide a much needed export vehicle for small- and medium-sized business.

As you may know, similar legislation, H.R. 1648, has been pending before the House Judiciary, Banking and Foreign Affairs Committees for a number of months. Unfortunately, this important and helpful legislation has been delayed due to what we consider to be somewhat shortsighted and parochial concerns. We were particularly disappointed by the Judiciary Committee's failure to take the initiative and report this legislation during that Committee's most recent meeting.

Of course, one of the essential elements of this legislation is the clarification of the parameters of U.S. antitrust law with regard to export trade activities. It is our firm belief that the increased certainty of application of the law which would be fostered by such clarification would have a significantly beneficial impact on encouraging numerous U.S. firms, which under current circumstances are discouraged by the irresoluteness of existing antitrust law, to participate in joint exporting ventures.

And as a vital provision in bringing about such increased certainty, we strongly support H.R. 1648's approach of placing primary responsibility for administering the export antitrust certification procedure in the Department of Commerce, in consultation with both the Justice Department and the FTC. We believe that this arrangement will enable many U.S. businesses to overcome their natural reluctance to untilizing the export certification procedure for fear that it will only serve to make them a target for Justice Department inquiries concerning their activities that may "spill over" into the domestic market.[3]

Although we appreciate the concerns held by some Judiciary Committee staff members concerning the antitrust and certification aspects of the Bill, we would urge them to exert every effort in reaching a consensus on this issue. We are hopeful that such a consensus will resolve the current impasse and thereby expedite this much needed legislation's enactment into law.

Another very significant aspect of H.R. 1648 is its expansion of current Webb–Pomerene associations' ability to compete in world markets by allowing the joint exporting of services as well as goods.

This is of great importance, especially given the importance of service trade in our overall current account as discussed above.

Finally, but not of least importance, both S. 734 as it has passed the Senate, and H.R. 1648, would enable banking institutions to become active participants in joint exporting ventures.

NMTBA believes that banks can bring to ETC's not only financial resources, but almost all of the supporting facilities and services which U.S. exporters now most lack by contrast with their foreign competitors. They will make it possible for American companies to combine their resources in a variety of ways and configurations in the interest of more competitive overseas marketing of American products and services. More importantly, banks can encourage and help exporters develop a long term view of, and presence in, export markets. Moreover, bank affiliated trading companies would have special effect on encouraging more medium and small exporters who are now discouraged by the remoteness and strangeness of foreign markets and buyers, exchange risks, and by the complexity and expense of documentation.

Although NMTBA supports the general principle of separation of banking and commerce, we believe there is good, sufficient, and, indeed, compelling reason to make an exception on a controlled basis for limited and conditional bank ownership of export trading companies in order to strengthen U.S. capacity to meet non-traditional international trade competition. Moreover, we further believe that as drafted, S. 734 contains prohibitions, restrictions, limitations, conditions and requirements more than ample to meet each of the objections raised concerning bank ownership of export trading companies.

In our view, any legislation purporting to encourage U.S. exports through the facility of export trading companies, which does not permit bank participation and (in some cases) the right of bank control is only a half step. Adequate financing is one of the most ciritical elements of export promotion. To continue to prohibit bank participation in export trading compaines is to continue a halfway policy of half steps leading to halfway results.[4]

B. Business Accounting and Foreign Trade Simplification Act

Once again we commend the Senate for its action in passing the Business Accounting and Foreign Trade Simplification Act. This measure, which amends the current Foreign Corrupt Practices Act, is an important step in eliminating much of the uncertainty which presently surrounds what is and is not acceptable business procedure overseas.

This proposal awaits action by the House Commerce Committee's Subcommittee on Finance of this House. We would strongly urge Chairman Wirth to act as soon as possible in taking another important step in making American business more competitive in the world market.

C. Taxation of income earned by American working abroad (I.R.C. §§ 911 and 913)

On another front, we congratulate this Committee for the reforms in this area of the law which were enacted in last summer's Economic Recovery Tax bill. These reforms will make it much more feasible for U.S. companies to employ U.S. citizens in foreign posts. And this practice, we are certain, will enhance U.S. industries competitiveness abroad, because inter alia U.S. citizens are more likely to turn to U.S. sources for equipping overseas construction projects.

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[3] U.S. Congress, House, Committee on the Judiciary, statement by National Machine Tool Builders' Association, May 7, 1981, before the Subcommittee on Monopolies and Commercial Law, Committee on the Judiciary, House of Representatives, during hearings on H.R. 1648 (title II) and related legislation, 97th Cong., 1st sess., 1981.

[4] U.S. Congress, Senate, Committee on Banking, Housing and Urban Affairs, statement of W. Paul Cooper; chairman of the board, Acme-Cleveland Corp., Feb. 18, 1981, before the Subcommittee on International Finances, Committee on Banking, Housing and Urban Affairs, during hearings on S. 734 and related legislation, 97th Cong., 1st sess., 1981.

D. Export-Import Bank and Domestic International Sales Corp. (DISC)

The Export-Import Bank and DISC are both very important and helpful programs designed to equalize the competitive disadvantage American firms often find themselves in overseas. Although in principle, it might be better to eliminate all forms of government leverage in international trade, it is not reasonable to expect the U.S. to take such action unilaterally. Even with the current levels of support from mechanisms such as the Export-Import Bank and DISC (small by comparison to the government subsidies enjoyed by foreign businesses) U.S. industry is at a disadvantage. Certainly, therefore, short of subsidy reductions by our competitors (which have not thus far been forthcoming) it would amount to surrendering before the battle was joined for the U.S. to reduce its export promotion programs from their current status.

Actually, now more than ever before U.S. exporters need the assistance of a strong and competitive Exim Bank. At a time when our economy is experiencing severe pressures from many directions, we should not lose sight of the fact that Exim Bank financed sales have generated at least 450,000 jobs in fiscal year 1981 alone.

However, we recognize, as Exim Bank President and Chairman William Draper pointed out earlier in these hearings, that Exim Bank is about to face a sharp conflict between its mandate to be competitive and its policy to operate on a self-sustaining basis. With the prospects of the Bank running its first loss ever in fiscal 1982, the resolution of these two competing objectives will be difficult indeed. But this is a challenge we must meet successfully if U.S. exporters are to have a chance of competing in world markets on equal footing with their foreign counterparts. To this end, we strongly urge the Congress to expeditiously consider alternative-financing devices that would result in budgetary savings while at the same time allowing Exim Bank greater competitive strength in order to insure a stronger competitive position for American exporters. And we commend the House for substantially increasing Exim Bank's lending authority beyond the paltry and non-competive figure reported by the Appropriations Committee.

E. Export administration laws and regulations and COCOM

To this point we have discussed the various methods by which the U.S. Government may assist American exporters in being more competitive in international commerce. Next we must consider what our policy should be concerning the parameters of permissible export trade. Specifically, we refer to the administration Act (E.A.A.), and application of COCOM regulations by our own government and those of our western trading partners.

NMTBA believes that the significant reforms brought about during the 1979 reauthorization of the E.A.A. have contributed greatly to a more efficient and realistic export control policy. Although as a general proposition our association and industry questions the efficacy of using trade as a "weapon," we recognize that there are perhaps occasions in which it may be appropriate to make international statements of policy by, to some degree, curtailing or restricting U.S. exports. However, we believe that such "foreign policy" controls should be clearly labeled as such, (as indeed they are required to be under the 1979 revisions to the E.A.A.) with Congress having an opportunity to be consulted prior to the implementation of such restrictions.

In contrast to foreign policy controls, we believe that "National Security" controls are only appropriate when they in fact serve their intended purpose of keeping certain commodities out of the hands of certain non-market nations. A key element which must be taken into account in the implementation of National Security controls is that of foreign availability—in other words, the realistic assessment of what is commonly available and being sold to potential adversaries by other trading nations. Too often, insufficient weight is accorded a showing by American exporters that products which they have been denied the right to export are freely available from other sources. Even more disturbing is the fact that often these other sources are our own western allies. This penchant for "shooting ourselves in the foot" must stop.

The Coordinating Committee (COCOM) was established to ensure a degree of uniformity among the major western trading nations policies concerning the transfer of militarily critical technology. Unfortunately, many of our own NATO allies have adopted a much looser interpretation of these rules than we have.

We have documented examples of cases in which U.S. machine tool builders have been denied export licenses for sales of certain controlled technology to Eastern bloc customers, only to later discover that a foreign competitor had made the very same sale. Going one step further, in some cases not only have foreign builders made what would be a prohibited sale for a U.S. manufacturer, they have even granted a company in the restricted country a license to manufacture the equipment in question.

Although we do not advocate restricting the sale of technology which is clearly antiquated and/or has no military application, we do strongly urge our government to vigorously address the issue of other COCOM nations lack of uniform compliance with legitimate and meaningful COCOM regulations.

V. EFFECTIVE AND WELL FINANCED U.S. INTERNATIONAL TRADE RELATED DEPARTMENTS AND AGENCIES ARE VITAL TO THE RESTORATION OF U.S. COMPETITIVENESS

As we stated at the outset, international trade is a vital element in the overall economic well-being of the United States. For this reason, unfair trade practices which disadvantage U.S. business cannot be tolerated. In this regard, we commend the efforts of U.S. Trade Representative Ambassador William Brock for his efforts in attempting to negotiate reduction in foreign government export subsidies. The International Arrangement on Guidelines for Officially Supported Export Credits, the Mexico-U.S. Joint Commission on Commerce and Trade, and the U.S.-China Joint Commission on Commerce and Trade, to name but a few, are major undertakings designed to achieve the resolution of this troubling international economic problem.

Obviously, it is much easier to negotiate from a position of strength than from one of weakness. Therefore, we strongly urge this Administration to continue its efforts to both promote and assist U.S. companies engaged in international commerce. Only in this way will U.S. business remain a viable international competitor while we await the hoped for reductions in foreign governments' involvement in the market place.

In this regard, we commend the efforts of Secretary Baldrige and the many fine people working under him at the Department of Commerce. Initiatives such as the the newly expanded Executive Council of the Trade Facilitation Committee, the Foreign Commercial Service, and Export Trading Company legislation are but several examples of the Department's aggressive export philosophy.

Of particular relevance to the machine tool industry is Secretary Baldrige's concern over the international trade practices of our Japanese competitors. As mentioned earlier, machine tool industry face just as serious an import challenge as does the automobile industry. And the similarity continues to the extent that much of this competition comes from Japan. Although it would be unjust and inaccurate to say that all Japanese imports are unfairly subsidized, there are, nevertheless, a number of cases in which we believe some Japanese builders have engaged in what are close to predatory trade practices.

For this reason, we applaud the remarks made by Secretary Baldrige while he was in Japan last month. Because the U.S. machine tool industry continues to maintain a preference for free and fair trade, we fully concur in the Secretary's belief that the current U.S.-Japanese trade imbalance should be "Redressed by expanded U.S. exports to Japan rather than [artificially] reduced Japanese exports to the American market".[5] To this we would only add that where appropriate, American businesses should pursue already available statutory remedies for unfair trade practices which impinge on the domestic market.

In conlcusion, NMTBA obviously recognizes the need for reductions in the overall federal budget as a key element in the Administration's economic recovery program. However, we also recognize, and have so stated, that international trade is a vital element in this nation's overall economic posture. Suggestions that the Commerce Department's export promotion acitivites be curtailed and that the foreign commercial service be disbanded are, in our judgment, the height of irresponsible unrealism.

We, therefore, strongly urge Congress to continue to finance the international trade promotion and assistance activities of the Federal Government at levels which will enable them to effectively carryout their important missions. To do otherwise will imperil U.S. export competitiveness, contribute to loss of business, and lead to more unemployment.

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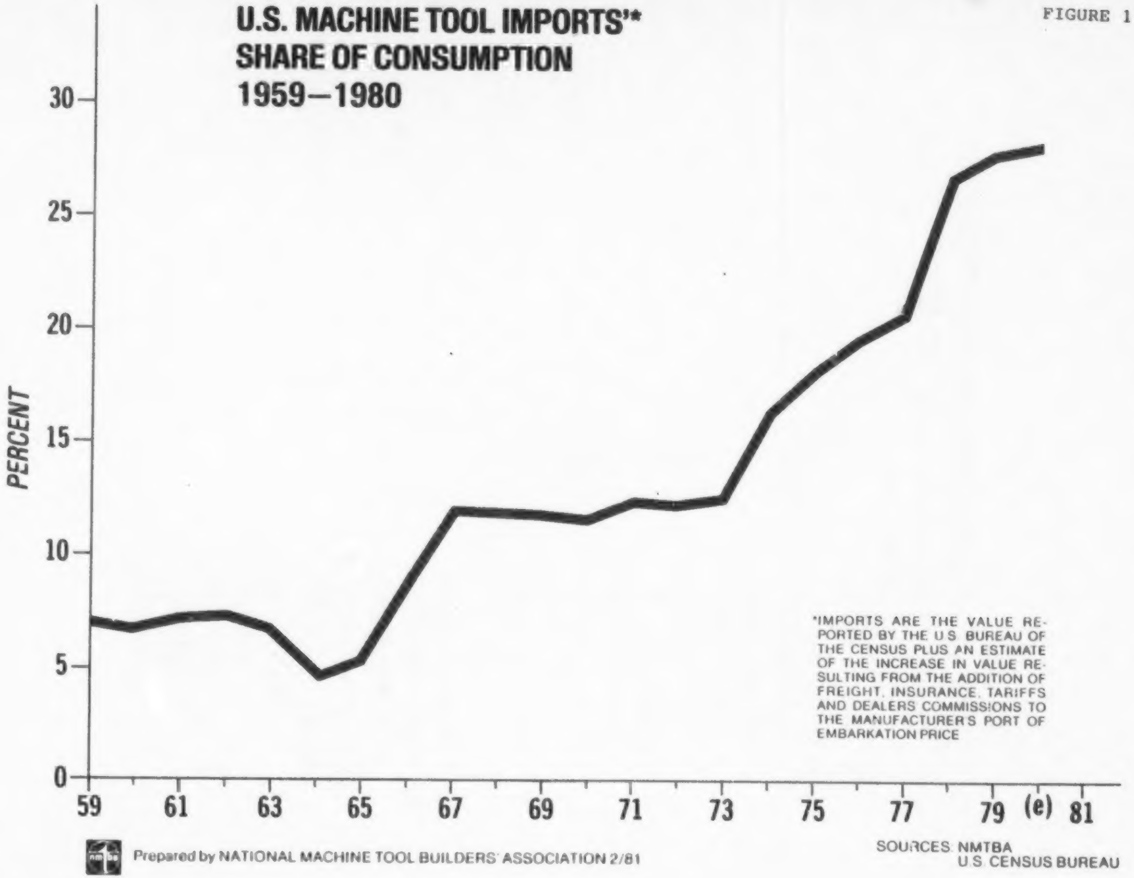
[5] Statements of U.S. Secretary of Commerce Malcolm Baldrige in the Japanese Press, ASAHI Evening News, October 30, 1981. See U.S., Congress, House, Committee on Ways and Means, statement of Hon. Malcolm Baldrige, Secretary of the Department of Commerce, Nov. 2, 1981, before the Subcommittee on Trade, Committee on Ways and Means, House of Representatives, during hearings on U.S. Trade Policy, 97th Cong., 1st sess., 1981.

FIGURE 1



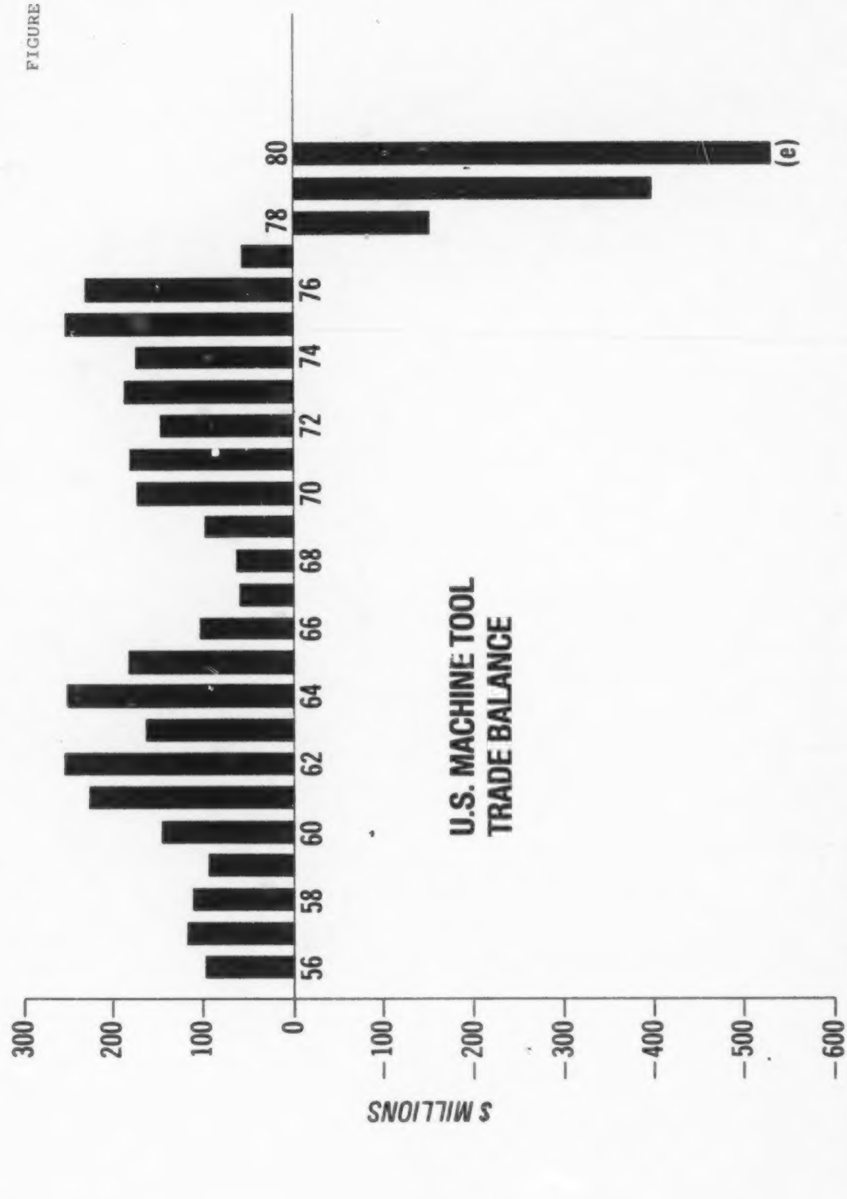
U.S. MACHINE TOOL IMPORTS'*
SHARE OF CONSUMPTION
1959—1980

*IMPORTS ARE THE VALUE REPORTED BY THE U.S. BUREAU OF THE CENSUS PLUS AN ESTIMATE OF THE INCREASE IN VALUE RESULTING FROM THE ADDITION OF FREIGHT, INSURANCE, TARIFFS AND DEALERS COMMISSIONS TO THE MANUFACTURER'S PORT OF EMBARKATION PRICE

Prepared by NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION 2/81

SOURCES: NMTBA
U.S. CENSUS BUREAU

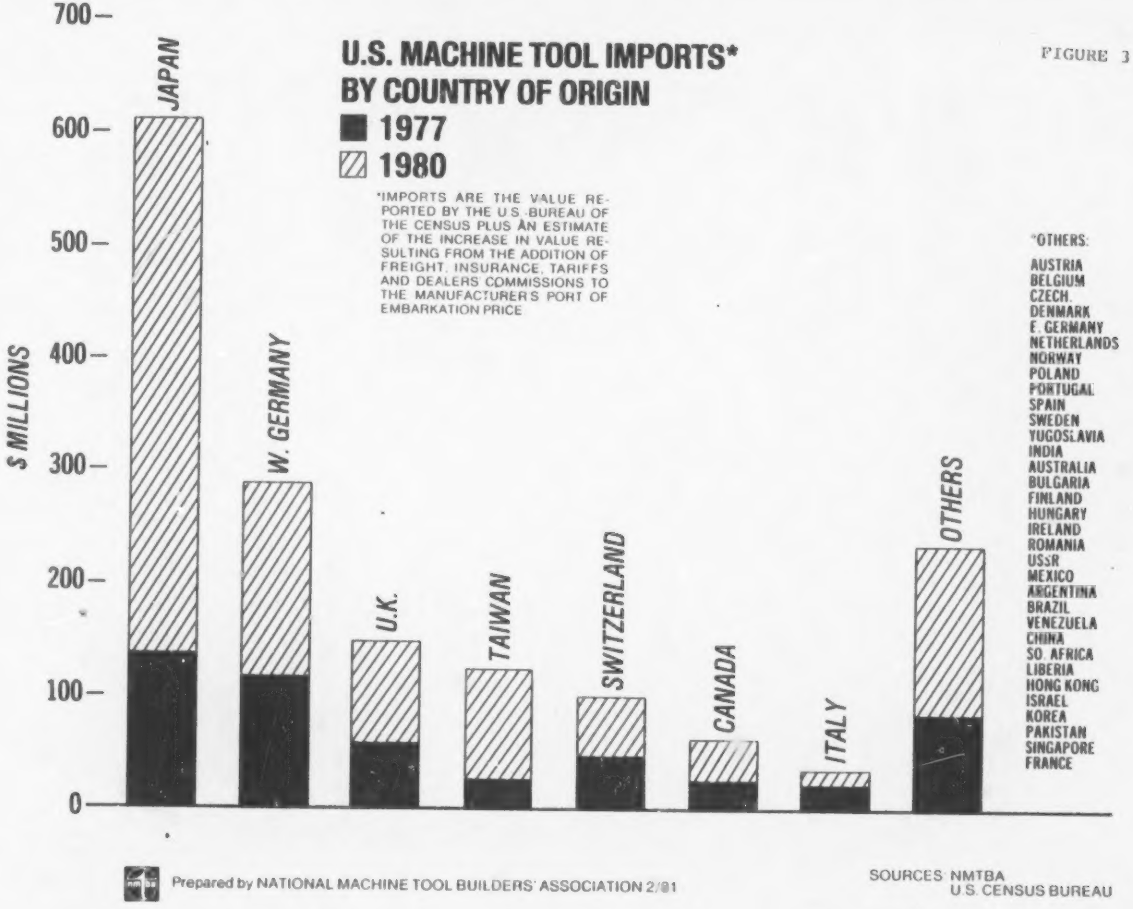
FIGURE 2



SOURCES NMTBA
U S CENSUS BUREAU

Prepared by NATIONAL MACHINE TOOL BUILDERS ASSOCIATION 2/81

FIGURE 3



U.S. MACHINE TOOL IMPORTS* BY COUNTRY OF ORIGIN

■ 1977

▨ 1980

*IMPORTS ARE THE VALUE REPORTED BY THE U.S. BUREAU OF THE CENSUS PLUS AN ESTIMATE OF THE INCREASE IN VALUE RESULTING FROM THE ADDITION OF FREIGHT, INSURANCE, TARIFFS AND DEALERS' COMMISSIONS TO THE MANUFACTURER'S PORT OF EMBARKATION PRICE

*OTHERS:

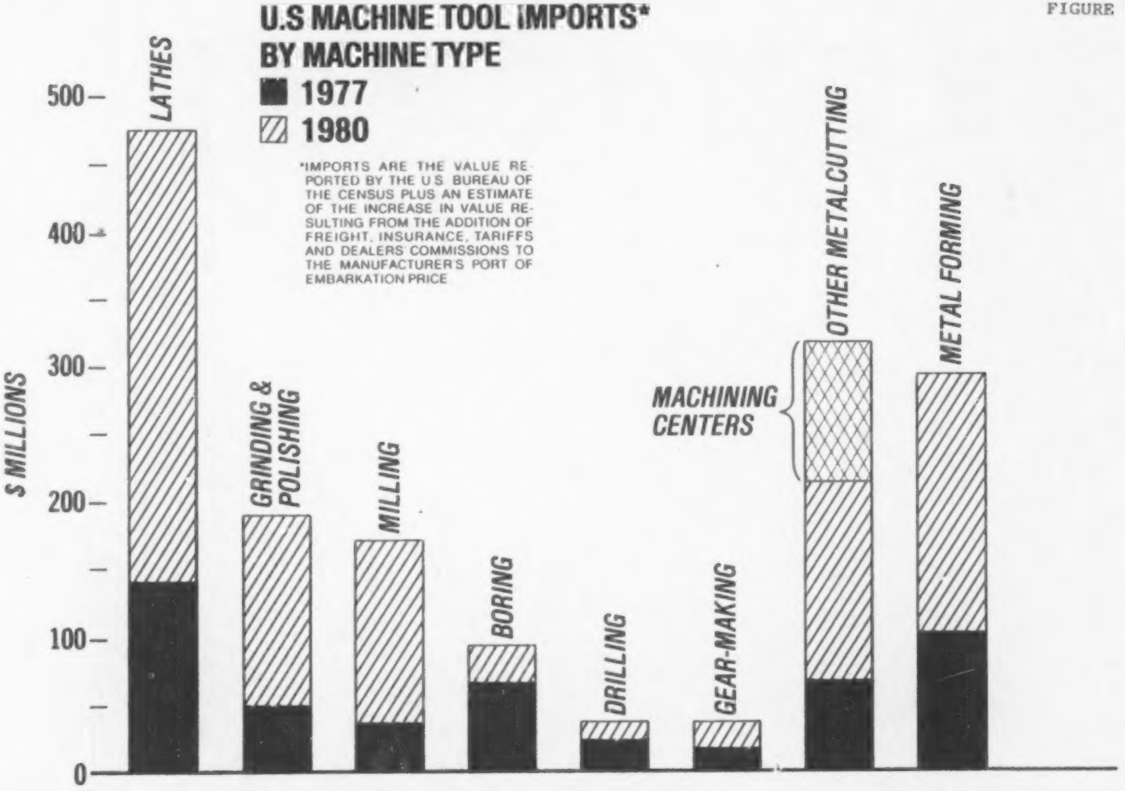
AUSTRIA
BELGIUM
CZECH.
DENMARK
E. GERMANY
NETHERLANDS
NORWAY
POLAND
PORTUGAL
SPAIN
SWEDEN
YUGOSLAVIA
INDIA
AUSTRALIA
BULGARIA
FINLAND
HUNGARY
IRELAND
ROMANIA
USSR
MEXICO
ARGENTINA
BRAZIL
VENEZUELA
CHINA
SO. AFRICA
LIBERIA
HONG KONG
ISRAEL
KOREA
PAKISTAN
SINGAPORE
FRANCE

$ MILLIONS
700
600
500
400
300
200
100
0
JAPAN
W. GERMANY
U.K.
TAIWAN
SWITZERLAND
CANADA
ITALY
OTHERS

Prepared by NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION 2/81

SOURCES: NMTBA
U.S. CENSUS BUREAU

FIGURE 4


U.S MACHINE TOOL IMPORTS*
BY MACHINE TYPE

*IMPORTS ARE THE VALUE REPORTED BY THE U.S. BUREAU OF THE CENSUS PLUS AN ESTIMATE OF THE INCREASE IN VALUE RESULTING FROM THE ADDITION OF FREIGHT, INSURANCE, TARIFFS AND DEALERS COMMISSIONS TO THE MANUFACTURER'S PORT OF EMBARKATION PRICE

Prepared by NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION 2/81

SOURCES: NMTBA
U.S. CENSUS BUREAU

Japanese Export Statistics

EXHIBIT 1

1975 - Japan's top ten machine tool export markets comprised 69.3% of the value of total exports. These were:

	Country	(millions of dollars) Value of Exports	% of Export Total
1)	USA	$47.3	22.8%
2)	Rep. of Korea	27.7	13.3
3)	PRC	10.7	5.2
4)	Brazil	10.4	5.0
5)	Taiwan	10.1	4.9
6)	Australia	8.4	4.0
7)	W. Germany	8.2	3.9
8)	Sweden	8.0	3.9
9)	U.K.	7.9	3.8
10)	Singapore	5.3	2.6
		$144.0	69.3%

1975 exports were 26.7% of Japanese production.

1980 - Japan's top ten machine tool export markets comprised 77.9% of the value of total exports. The top ten were:

	Country	(millions of dollars) Value of Exports	Growth*	% of Export Total
1)	USA	$471.1	58%	39.6%
2)	W. Germany	99.3	65	8.4
3)	U.K.	64.4	52	5.4
4)	Rep. of Korea	55.1	15	4.6
5)	USSR	53.4	34	4.5
6)	Taiwan	51.0	38	4.3
7)	S. Africa	39.5	57	3.3
8)	Belgium	34.4	NA	2.9
9)	France	28.9	NA	2.4
10)	Australia	28.5	28	2.4
		$925.6	45%	77.9%

1980 exports were 39.5% of Japanese production.

* Average annual growth rate for years 1975 to 1980.

Source : Japanese Tariff Association

Spring 1981

STATEMENT OF THE NATIONAL MASS RETAILING INSTITUTE, BY ENDICOTT PEABODY, GENERAL COUNSEL

Mr. Chairman and members of the House Ways and Means Subcommittee on Trade, on behalf of the National Mass Retailing Institute ("NMRI"), I am grateful for this opportunity to present testimony concerning trade policy in general and its effect on retailers. NMRI is a trade association representing the discount merchandising industry, with over 10,000 member stores in 48 states and over $50 billion in annual sales. NMRI is significantly affected by our nation's trade policies and, more particularly, by the extent to which its members can provide their customers with the greatest variety of goods with the highest possible quality at the lowest possible prices.

I. STATEMENT OF GENERAL PRINCIPLES

NMRI strongly supports the principle of free trade, based on mutually acceptable trading relations, as essential to a strong United States economy. Concomitantly, NMRI opposes protectionist measures designed to reduce access to markets at home and abroad.

The case for free trade is rooted in the basic economic principle of comparative advantage: free trade allows for greater efficiency in the allocation of economic resources and more prosperity for greater numbers of people. Moreover, economic theory is supported by the historical record. The acceleration in world trade and economic growth in the 1960's, to give a recent example, directly followed the sharp, mutual reduction in tariff barriers as a result of the Kennedy Round of trade negotiations. Great attention has been given to the increase in imports in the last twenty years. But it must also be remembered that in 1960, United States exports of goods and services were less that 6 percent of GNP; in 1980, as a result ot expanded trade following the Kennedy Round, exports accounted for more than 13 percent of GNP.

Free trade is particularly important to retailers, who consider imports as part of their overall merchandising program. Retailers buy merchandise for resale on the basis of anticipated consumer demand, analyses of the selection, quality, availability and price of the goods in the market. The relative weight assigned to the above factors varies from retailer to retailer, product to product, and year to year. However, price is particularly important to the nation's discount retailers, since the industry by definition is based on competitive pricing practices.

The only publicly available empirical data on retail price differentials between merchandise of domestic origin and merchandise of foreign origin demonstrates the importance of free trade to American consumers. The 1978 study by William R. Cline, Senior Fellow of the Brookings Institution, showed that retail prices on imported merchandise averaged 10.8 percent lower than the prices on the comparable domestic product. Based on the spending patterns of low-income consumers, the Cline study found that retail prices on foreign-made products were even lower, averging 13.1 percent less than the comparable domestic product. Overall, the study concluded that American consumers directly saved over $2 billion each year by purchasing imported general merchandise.

Free trade also plays an important role in insuring the economic health of the nation by helping to contain inflation. As a result of retailers access to foreign markets, inflation for general retail merchandise has been averaging only about a half of the overall inflation rate as measured by the Consumer Price Index. In 1980, for example, the annual increase in the general merchandise price index was approximately 7.7 percent, while the increase in the CPI was 13.3 percent.

In sum, NMRI supports free trade as an important key to economic growth, continued prosperity and lower inflation. With particular respect to the retail industry, free trade ultimately insures that American consumers have access to the greatest choice of goods, with the highest possible quality, at the lowest possible prices.

II. SUPPORT FOR EXTENSION OF THE MULTIFIBER AGREEMENT

Notwithstanding NMRI's strong support for the general principle of free trade, we recognize the particular import sensitivity of the textile industry in this country. In that vein, NMRI recognizes the important role that the Multi-Fiber Agreement has played in recent years to bring some order to a politically volatile issue. While in an ideal world, the MFA should not be necessary, we believe that the agreement generally has worked well to increase the markets for textile products from developing countries while insuring that domestic industries are not flooded by unregulated growth.

NMRI supports the extension of the Multi-Fiber Agreement, which is due to expire December 31st of this year, in its present form without major changes or modifications. We urge the U.S. negotiators in Geneva to resist pressures from the European Economic Community and the domestic textile industry to reduce existing quotas and to penalize the major Asian exporters.

To this end, NMRI notes that the textile industry in the United States is already the most heavily protected industry in American history. A 1978 study by the President's Council on Wage and Price Stability calculated that present tariffs on imported textiles and apparel cost the American consumer over $2.7 billion each year, while apparel quotas cost the consumer some $370 million annually. The bottom line according to the Council study, is to provide an $81,000 subsidy out of the pockets of consumers for each job purportedly protected by the MFA textile and apparel quota system. NMRI believes, that given this level of protection, it would be a tremendous step backwards to reduce existing quotas or to single out major exporters such as Hong Kong, South Korea or other Asian countries for particular protectionist measures.

At the same time, NMRI is concerned that the United States, as a signatory country to the MFA and more than 20 bilateral agreements negotiated pursuant to the MFA, has not always lived up to the letter and spirit of the agreements to which it is a party. The terms of the MFA and the bilateral agreements are supposed to provide certainty to those affected by them, since the MFA provides guidelines for the content of the bilaterals and bilaterals are binding commitments of the governments which sign them. Yet recent actions by the United States have strained the provisions of the MFA, violated the terms of particular bilateral agreements, and forced other governments to change the terms of agreements in the middle of the periods for which they were negotiated. These actions have caused significant problems for retailers who have borne the costs of unexpected restrictions and quota reductions in contravention of the bilaterals.

For example, the United States demanded and obtained reductions in the 1981 calendar year quotas for South Korea, Taiwan and Hong Kong in negotiations conducted in late February 1981. Many retailers who use quota levels in making their buying plans had already placed orders for goods covered by these reductions. Some were forced to cancel their orders, others were forced to ship the covered goods earlier than planned, and still others simply gambled that an embargo would be averted in the end.

The United States has also often demanded or unilaterally imposed quotas solely on the basis of the size of import levels, notwithstanding the fact that the MFA and most of the bilaterals specify that quotas are justified only in cases where the imports at issue are causing or threatening to cause "market disruption." Market disruption is defined in the MFA as "serious damage" to the U.S. industries producing those products. Basic international trade law and standard market analysis, however, view mere volume of imports as only one factor in determining whether as industry is injured by imports. Accordingly, NMRI believes that the United States should analyze other indicia of industry health in considering questions of "market disruption" under the MFA, such as profits, production employment, capacity and capacity utilization. Particular emphasis should also be given to the specific relationship of the imports in question to industry conditions.

In order to alleviate the specific problems alluded to above and to improve the overall administration of the textile and apparel import program, NMRI joins with the American Retail Federation in recommending the following:

(1) *Cabinet review.*—An appropriate Cabinet-level body—the Cabinet Council on Commerce and Trade or the Trade Policy Committee or both—should conduct a full review of the U.S. textile and apparel program. Interested members of the public and affected industries and workers should be afforded the opportunity to provide their views as part of this review. The result should be guidelines for U.S. negotiators on the parameters of acceptable negotiating positions and a policy for harmonizing this program of protection with the overall U.S. policy of free trade. At a minimum, our negotiators should be instructed to strictly adhere to the internationally agreed upon terms of the MFA and our bilaterals.

(2) *Better information.*—The government should establish a regularized system of collecting, disseminating and analyzing data on the condition of the U.S. textile and apparel industries and on their efforts to compete in the marketplace. This will allow all interested parties to engage in informed discussions over proposed U.S. actions. At present, data on the U.S. industries is either not available or is out of date. We suggest that the U.S. International Trade Commission, which has substantial experience as a result of its "escape clause," antidumping and countervailing duty responsibilities, should be asked to coordinate this effort.

(3) *Due process.*—The government should establish a system of advance notice and consultation far beyond current efforts. All interested parties should be afforded equal rights of participation. This process should be established to allow advance consultation prior to negotiations on basic multilateral and bilateral agreements and, especially, prior to any mid-term changes in those agreements.

STATEMENT OF PATRICK B. HEALY, SECRETARY, NATIONAL MILK PRODUCERS FEDERATION

The National Milk Producers Federation is a national farm commodity organization representing the dairy cooperative marketing associations throughout the nation and their dairy farmer members. The bulk of the nation's milk supply is marketed through these cooperative associations which farmers have developed as a means of providing themselves with representation in the market.

In their roles as both producers and marketers, farmers are concerned with actions which affect the supply of milk and dairy products and which impact on the price they receive for their milk.

Dairy farmers in all areas of the country rely heavily on the Dairy Price Support Program authorized under the Agriculture Act of 1949. This program provides farmers with a minimum degree of price assurance so as to induce farmers to accept the risks involved in devoting the required land, labor, capital and management to the production of milk to meet the needs of the market. Since its enactment in 1949, this program has been singularly successful in assuring that market needs have been met at prices that are reasonable to the consumer.

Over the past two years, there has been growing criticism of the Dairy Price Support Program due to increasing government costs associated with the purchase of dairy products not absorbed by the commerical market. As a result, the Agriculture and Food Act of 1981 made major revisions in the program, including reducing the price support level to the lowest relative level since the program's enactment. These changes are intended to bring about a reduction in milk production and, through that, a reduction in government outlays.

Largely overlooked in the debate surrounding the legislation was the fact that the present expansion of milk production has been coincident with a 40 percent decline in realized net farm income. The potential return to milk production relative to other major agricultural enterprises has encouraged the shift of resources to dairying where possible. In seeking reduced costs under the Dairy Price Support Program, the Congress chose a method that treats the symptom rather the the basic problem.

As part of the complex of legislation that represents a national food policy, Congress has enacted Section 22 of the Agricultural Adjustment Act. This measure is intended to assure the effective operation of domestic price support and similar programs by preventing excessive and unneeded imports from interfering with them.

Since 1953, this authority has been used to develop a fairly comprehensive system of import restraints on dairy products. This has been necessary to prevent the U.S. market from becoming a dumping ground for world diary surpluses, most of which can gain access to the market only with the assistance of substantial export subsidies.

A series of recommendations has been made for revisions in the law governing dairy product imports or changes in the regulations under which these products are admitted. These changes would have the effect of expanding cheese imports, totally removing any effective control over the application of export subsidies and increasing government costs under the Dairy Price Support Program.

Elimination of the price undercutting prevention mechanism provided as part of the Trade Agreements Act of 1979 would be a legal sanction of the restrained use of the export subsidy to erode the domestic market. Suggestions that importers are placed in "double jeopardy," that they might unwillingly be subjected to added fees as the result of this program or that adequate relief is available under the countervailing duty statue, are without foundation.

The law is directed totally to preventing the use of export subsidies by other nations from undercutting prices in this market. A major goal of the United States during the Tokyo Round of multilateral trade negotiations was the elimination of export subsidies in international trade. This effort was an absolute failure. What did result was subsidies code which actually sanctions the use of export subsidies. This fact, plus the accompanying crippling of the countervailing duty statue, led the dairy industry to seek some means of preventing subsidized imports from routinely undercutting this market.

No importer risks application of the law if the products imported carry to export subsidy or if any subsidy applied is such that it does not allow the sale of the product at less domestic market prices.

The dairy industry does not regard the price undercutting law as an adequate replacement for the countervailing duty statue as it stood prior to the MTN. With the changes made in the law as the result of the trade talks and the shift in its administration, however, it stands as an almost totally useless vehicle to prevent this type of unfair competition.

The price undercutting law is not fully adequate to meet its intended purpose. Exporting nations have rountinely provided export subsidies sufficient to allow the undercutting of prices in this market. The law, however, does not provide the Secretary of Agriculture the authority needed to gather the detailed pricing information necessary to prevent such action. Rather than eliminating the law, a strengthening of the statue so as to provide for its full enforcement would best serve the domestic industry and those importers not engaging in such marketing practices.

The licensing system employed by the U.S. Department of Agriculture to administer Section 22 quotas does provide a mechanism for the transfer of quotas between countries or origin. This has been widely used to provide for the fullest possible use of quota authority. Adoption of the recommended trigger mechanism for such transfers would allow license holders to manipulate the system in a manner that would, in effect, permit them to shop the world market. It would be seriously disruptive to U.S. trade relations and, more importantly, introduce an added element of disruption into their market.

There is a 2,000 metric ton portion of the increased cheese imports agreed to by the United States under the MTN that has never been allocated. It was unclear at the time of the negotiations what the purpose of this additional quota was. The passage of time has not provided any additional insight. To allocate this quota at this time would simply mean that the United States would be opening its market to an additional 4.4 million pounds of cheese at a time when the domestic dairy industry is already faced with too much product. This would merely add to the purchase of dairy products under the Dairy Price Support Program.

The proposed combination of the Section 22 quotas for natural and processed cheese would be the final legalization of actions originally intended to evade established quotas. The admission that little market exists for these of the processed products is noteworthy. This is exactly what the domestic industry has contended over the years. The products were developed as a means of evading established quotas on natural cheeses. They stand as a monument to the repeated success of evasion efforts.

A more logical means of addressing this issue would be the administration of Section 22 import quotas on a milk equivalent basis rather than the product-by-product system presently used. The National Milk Producers Federation has recommended such a system to the Department of Agriculture, the U.S. International Trade Commission and the Congress. Such a system would permit the mix of imports to address the needs of the market. It would also effectively reduce the potential for evasion which exists under the current system.

The proposal to provide an automatic system of import increases based on population growth, increases in cheese consumption or some combination of these is interesting. It is surprising that importers would make such a recommendation. In 1980, U.S. cow's milk cheese imports totaled 207,545,000 pounds, 5.2 percent of U.S. consumption. In 1955, imports were 4.1 percent of U.S. cheese consumption. If imports were to have been increased on the basis of U.S. consumption, using 1955 as a base, 1980 import levels should have been about 163 million pounds.

But before we get too carried away with such a proposal or any others, it would be well to examine the conditions that require the United States to maintain limitations on dairy product imports. The fact is that the world market for dairy products is a fiction. Prices are not determined by the market value of the products but by the willingness of nations or groups of nations to subsidize the export of their products into other markets. There are few, if any truly open markets. Dairy product exports from major trading nations are often controlled through quasi-governmental agencies.

The United States leads the world in cheese production. Excluding intra-Economic Community trade, the United States is also the world's largest cheese importer.

But, whereas the EC exported 10.5 percent of its cheese production last year to non-EC destinations, U.S. exports were about 1.1 percent. A substantial portion of EC cheese exports were to the United States. U.S. nonparticipation in the market was not because of lack of product, it was not because of uneconomic production, it was not because the product was not or could not be tailored to meet markets needs. It was because U.S. policy does not allow it.

The United States does not employ export subsidy programs to assist the export of dairy products. On a straight price basis, U.S. production would be competitive in most European markets, however use of variable levies by the EC and other devices by other countries exclude imports.

One might deplore the use of import quotas as a means of regulating trade, but unless and until policies are adopted which will permit U.S. industries to compete by the same rules others use in international trade, they will remain necessary.

DANIELS, HOULIHAN & PALMETER, P.C.,
Washington, D.C., February 16, 1982.

Hon. SAM M. GIBBONS,
Chairman, Subcommittee on Trade, Committee on Ways and Means,
Washington, D.C.

DEAR MR. CHAIRMAN: At the Committee's recent oversight hearings on U.S. trade policy, witnesses for the Cheese Importers Association of America presented testimony concerning the U.S. Department of Agriculture's regulations governing the importation of cheese. In a portion of this testimony, the Cheese Importers Association urged the abolition of the "designated importer" provisions of the regulations and allocation of the cheese imported by designated importers to historical importers, i.e., themselves.

We strongly disagree with the Cheese Importers' position, and submit that the testimony of the Association significantly mischaracterizes the designated importer provision, and distorts its operation and impact. The "designation importer" provisions of USDA's regulations in fact serve to liberalize trade as much as possible within the confines of a quota system.

Our client, Norseland Foods, Inc., of Stamford, Connecticut, is a wholly owned subsidiary of the Norwegian Dairies Sales Association (NDSA), Oslo, Norway, and acts an importer, agent, and marketing coordinator for its parent. Norseland is the "designated importer" of cheese from Norway, a status that helps it manage the United States business of its parent. Its functions include the duties of importer, agent, marketing coordinator, and distributor.

We will state for the record, and challenge anyone to refute, this basic statement: No traditional importer of Norwegian cheese has been deprived of the opportunity to sell Norwegian cheese in the United States because of Norseland's role as "designated importer." The opposite is the case—Norseland's designation has permitted a degree of flexibility in the trade which has maximized the opportunities of U.S. firms to deal in Norwegian cheese.

The Cheese Importers Association—representing a group of firms who hold import licenses based upon their historical status as importers—would have the Committee believe that they have been so deprived, but the facts are to the contrary. To understand why this is so, one must be careful of the loose terminology employed by the Cheese Importers—who wrongly equate import licenses with imported cheese.

NDSA is Norway's only dairy cooperative, encompassing all of the milk producers in that country, and is the sole exporter of natural Norwegian cheese. Norseland is its U.S. arm. Accordingly, sales of cheese to U.S. wholesalers, distributors and importers form Norseland are the economic equivalent of sales from NDSA Norway. American companies may buy Norwegian cheese from NDSA, Oslo, or from NDSA, Stamford, Connecticut, under the name of Norseland. It is all the same cheese, and it all comes from the same source.

The only distinction is the technical one of importation. To the extent that U.S. businesses have import licenses, they are entitled to import cheese and NDSA is compelled to do business with them or to forego those sales in the United States. However, to the extent that NDSA imports its own cheese into the United States (through Norseland), it is free to deal with U.S. customers based upon purely commercial considerations, rather than under compulsion. There is nothing either startling or unusual about doing business upon purely commercial considerations—despite the protestations of the Cheese Importers. To the contrary, this is the way business normally is done.

Prior to the imposition of the current, expanded, cheese quotas, NDSA and Norseland were in the process of establishing a system whereby NDSA would ship its cheese to the United States for the account of Norseland, which then would distribute it throughout the country—in accordance with commercial considerations. Before this plan could be completely implemented, however, the United States imposed import quotas upon cheese from Norway, and proposed to award import licenses to other businesses, based upon their importations in the past.[1] In order to alleviate somewhat the harshnesss that this scheme would have on NDSA's legitimate business plans, the Department of Agriculture permitted half of the quota to be imported by entities designated by the government of the exporting country. Norseland was so designated by the Government of Norway.

What this means in actual practice is that NDSA has the right to control the sales of half of its own product in the United States. If it is dissatisfied with the way in which certain customers are handling the cheese, it can shift to others.[2] If demand picks up in one section of the country, or falls in another, NDSA is free to respond. But in situations where it must deal with license holders, it does not have this flexibility. For example, for nearly a year one licensed importer—who has the sole right to import a portion of the Norwegian quota—simply has not paid its bill. While, eventually, U.S. Department of Agriculture regulations will permit some alleviation of this type of problem, the fact is that in the interim, NDSA has been forced to do business with a company with which it would have fewer dealings if only commercial consideration applied. This is not to criticize NDSA's regulations: given the magnitude of the problem that agency has in trying to deal with the complicated question of the equities involved in cheese quotas, we quite frankly are at a loss to suggest how they might improve the situation. This kind of problem simply is inherent in any licensing scheme.

NDSA and Norseland, accordingly, suggest that a major step which could be taken to overcome the inherent inequities of import licenses is simply to abolish them. They are not needed. Quantitative limits have been placed upon the amount of cheese that may enter the United States during a given year in order to achieve certain protective purposes in the U.S. market. But the U.S. Government does not need to select the particular companies who may import that cheese in order to further the protective purpose. Thus, U.S. milk producers and the cheese industry may have a legitimate interest in how much cheese is imported into the United States, but they have no legitimate interest in the identity of the particular importer. Put another way, prior to the imposition of these quotas, NDSA was free to sell as much cheese as it wished to whomever it wished. The quotas have eliminated its right to sell as much as it wishes, but the quotas should not restrict its right to sell to whomever it wishes. There is no need to restrict a seller's selection of its customers in order to protect a domestic industry or price support program.

Accordingly, we urge that the Committee take whatever action is necessary to eliminate completely all cheese import licenses for Norway, and to place those imports on a first-come-first-serve basis. This would be the most efficient market allocation that could be made, and would provide Norwegian cheese to all in the U.S. who want it. If it is not possible to take these steps, at the very least, the designated importer provisions should be retained in order to permit as much flexibility as possible for sellers to respond to market conditions.

Very truly yours,

N. DAVID PALMETER.

STATEMENT OF WALLACE D. BARLOW, EXECUTIVE DIRECTOR, SHARE THE WORK COALITION

The Share the Work Coalition is known as the principal advocate of a "tilted" corporation tax. We would tilt in favor of the labor intensive industries. In a poll of all of the candidates for Federal office in the 1980 elections, 82 percent of the respondents favored "TILT".

We advocate a tariff schedule which would be tilted in the same manner, i.e. on the basis of labor content, as well as wage levels. The higher the labor content, the higher the tariff, since five times as many jobs may be involved. (Labor content is defined as wages as a percentage of value added.)

There is already a correlation between high labor content and high tariffs. We are suggesting that these determinations be made in a precise and systematic manner and from a common data base.

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[1] Norseland was incorporated in Connecticut on July 5, 1978.

[2] Norseland utilizes a considerable quantity of the cheese brought in under the "designated importer" provision to supply many traditional customers who, in the past, purchased after customs entry and thus did not have an historical record on which to obtain licenses. In the absence of this provision, these firms would experience extreme difficulty in continuing in the business.

We visualize computers in Tokyo, Singapore, London, etc., operating on the same data base and containing in their memories the following: (1) Wage levels for each Nation and industry; and (2) labor content for each product by Nation and by SIC number.

To determine an equitable tariff for product A being exported from Nation 24 and imported by Nation 56, for example; one would enter the computer with an SIC number, the code for the exporting Nation and the code for the importing Nation. The machine would compute a weighted average of the wage level ratios and the labor content ratios and read out an equitable ad valorem tariff rate.

We ask that Enclosure (1), which shows the labor content for some U.S. industries, be included in the record.

We also ask that Enclosure (2), the introduction to the book recently published by the Coalition, also be included in the record.

In closing, it is our view that labor content is relevant. IT MUST be considered in future trade negotiations.

SHARE THE WORK COALITION

We represent the twenty million unemployed persons of the Free World

Wallace D. Barlow
Executive Director

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ATTENTION WAGE-EARNERS: It is to your advantage to spend your money with the industries that are likely to return more than half of your money in the form of wages. In the United States the "Labor Content" of manufactures varies from 52% for shipbuilding to 10% for cigarettes. This means that the shipbuilders deserve your support. If one of these companies goes bankrupt, five times as many jobs are wiped out.

The COALITION, (A coalition of labor organizations and the labor intensive industries), hopes to be able to include in President Carter's omnibus tax reform bill a "tilting" of the corporation tax to provide a lower tax rate for the labor intensive industries and a higher rate for the automated industries. This may reduce productivity somewhat but it would improve the quality of life in the United States by wiping out the welfare system . It would create jobs for everyone willing to work.

In order for this plan to work, the demand for the products of the labor intensive industries must be increased at the expense of the automated industries. We ask that you discriminate in favor of your friends.

YOUR FRIENDS		YOUR ENEMIES	
Industry	Labor Content		Labor Content
Ship Building and Repairs	51.9%	Cigarettes	10.3%
Ordnance and Accesories, n.e.c.	48.6	Agricultural Chemicals	11.4
Motorcycles, Bicycles, Parts	46.4	Petroleum & Natural Gas Production	12.3
Apparel, other Textile Products	46.0	Finance, Insurance & Real Estate	12.7
Non-ferrous Foundries	45.3	Soaps, Cleaners, Toilet Goods	14.6
Electronic Components, Accesories	45.1	Pipeline Transportation	15.4
Musical Instruments	44.9	Petroleum Refining	15.6
Communication Equipment	44.4	Utilities, (Elec. Gas etc.)	16.7
Guided Missles, Space Vehicles	44.1	Industrial Organic Chemicals	17.3
Iron and Steel Foundries	43.9	Legal Services	19.5
Railroad Transportation	43.6	Misc. Foods & Kindred Products	20.3
Metal Services, n.e.c.	43.3	Drugs	20.5
Millwork, Plywood, Structural Members	43.1	Misc. Petroleum, Coal Products	21.4
Sawmills and Planing Mills	42.8	Sugar, Confectionery	21.8
Pottery and Related Products	42.6	Photographic Equipment & Supplies	22.3
Metalworking Machinery	42.6	Fats & Oils	23.1
Textile Mill Products	42.4	Telephone & Telegraph	23.2
Leather Products, exc. Footwear	42.2	Grain Mill Products	23.5
Furniture and Fixtures	42.1	Beverages	23.7
Engineering & Scientific Instruments	41.8	Industrial Inorganic Chemicals	23.8
Water Transportation	41.5	Coal Mining	24.1
Opthalmic Goods	41.4	Cement, Hydraulic	24.7
Contract Construction	41.3	Misc. Chemical Products	25.3
Aircraft and Parts	41.0	Preserved Fruits and Vegetables	25.7
Footwear, except Rubber	41.0	Quarrying & Non-metallic Mining	26.4
Blast Furnace, Basic Steel Production	40.8	Auto Repair, Services & Garages	27.0
Metal Forgings and Stampings	40.8	Wholesale Trade	27.0
Railroad Equipment	40.8	Tobacco Products, exc. Cigarettes	27.4
Cut Stone and Stone Products	40.4	Primary Nonferrous Metals	27.7
Misc. Professional Services	40.4	Paints & Allied Products	27.7

Footnote: "Labor Content" is defined as wages as a percentage of value added.

Encl. (1)

Excerpt from "LABOR CONTENT OF U.S. INDUSTRIES"

I. INTRODUCTION

Western Europe is turning to the left. If this continues, NATO is doomed. Why? Because twenty-four million persons are jobless and because these persons are aware that the communist governments, despite their lack of efficiency, are willing to "Share the Work". They promise jobs to all, adequate pensions and free health insurance.

The SHARE THE WORK COALITION believes that this aspect of communism has merit. Accordingly, we have invented "TILT", a plan that would preserve the Free Enterprise System by rewarding businesses that create jobs at the expense of the businesses that destroy jobs.

In order to understand "TILT", it is neccessary to understand the role played by labor content. In order to put TILT into operation a guide to the labor content of U.S. industries is needed, and has been produced.

(Labor Content is Wages as a percentage of Value Added. For our purposes, wages are broadly defined. Wages are payrolls, minus proprietary income and the salaries of top management. Value Added is the Value of Shipments, minus the cost of energy, materials and containers.)

The Share the Work Coalition advocates an attack on unemployment that deals directly with the disease, not with symptoms. We have discovered that the labor content among industries varies greatly - from 13% in Oil and Gas Extraction to 56% for Shipbuilding, for example. Therefore, it follows that dollars spent with the high labor-content industries will create five times as many jobs as money spent with the low labor-content industries. Faced with the dire consequences of chronic high unemployment and unrelenting inflation, how can we continue to disregard the critical importance of labor content?

The Coalition urges the adoption of the TILT concept: That is, we would amend Section 11b of the Internal Revenue Code by striking out the fixed rate, currently 46%, and providing for a proportionately higher corporation tax rate for the low labor-content industries and a proportionately lower tax rate for the high labor-content industries such as textiles, shipbuilding and footwear. This tax would continue to yield about $60 billion per year, but resources would be transferred from the capital-intensive industries to the labor-intensive industries. The advantages of substituting labor for capital would soon become obvious.

The labor content of manufactures in the United States has fallen from 46% in 1870 to about 28%. This is the real source of unemployment and its corollaries - crime, moral decay and terrorism. The Coalition does not propose to repeal the Industrial Revolution; however, we do propose a way to moderate its impact on our quality of life.

Taxation as an instrument of economic policy has been available since 1538. We believe that the time has come to put it to work to rescue the Free Enterprise System. TILT provides a solution that does not require millions of case workers. When TILT arrives, the welfare bureaucracy can be dismantled and dignity restored to our citizens.

An exposition of TILT is bound into this booklet. The results of a poll of all Federal candidates for office, taken during the 1980 elections, appear on the last page. Eighty-two per cent of the respondents gave an affirmative answer to the question: "Will you support the SHARE THE WORK COALITION plan to tilt the corporation tax?"

Encl (2)

BEST AVAILABLE COPY

STATEMENT OF J. PAUL LYET, CHAIRMAN, SPERRY CORP., AND CHAIRMAN, PRESIDENT'S EXPORT COUNCIL

I am grateful to the Subcommittee on Trade for providing me with this invitation to present some of my views on international trade issues. My perspective has two facets: that of a businessman who heads a leading multinational corporation, and as a citizen who is privileged to be the chairman of the President's Export Council.

Sperry Corporation is one of the world's largest industrial corporations. For the fiscal year that ended on March 31, 1981, Sperry's revenues exceeded $5 billion.

Sperry is engaged in diverse growth industries that include computer systems, farm equipment, fluid power equipment and aircraft and marine instrumentation.

The company employs approximately 90,000 people worldwide, operates around 60 manufacturing facilities in 11 countries and has subsidiaries and joint venture companies in over 30 countries

Sperry, then, has a vested interest in international commerce, and is one of the United States' largest exporters of manufactured products. Our total in fiscal year 1981 was more than $790 million. Of that amount, Sperry Univac—a major world manufacturer of computer systems—accounted for about 56 percent, or around $446 million.

Moreover, during fiscal year 1981 we exported products and services from 29 countries. Our worldwide volume of exports amounted to about $1.2 billion. Most of that was Sperry internal trade, such as shipments of completed products for sale elsewhere, parts, components and software. More than $286 million of the total, however, was in exports directly to outside customers.

Sperry is, therefore, truly a worldwide company, and it is subject to all of the pressures, red tape and barriers that afflict international commerce everywhere. But despite our commitment to the principals of open and fair trade, we often ask ourselves why, if international trade is such a boon to mankind, are there so many barriers to it?

The answer, in a word, is nationalism. Unfortunately, nations see their exports as an absolute benefit and their imports as a marginal benefit. So, when imports create competition, the marginal benefits turn negative for the domestic economy. People feel threatened, especially if jobs are impacted. Governments react, and protectionism often results.

Imports, obviously, are far more sensitive politically than are exports. This is a problem as old as international trade, and it causes the constant recurrence of protectionism.

The General Agreement on Tariffs and Trade (GATT) has only been a partial solution, though clearly it is a foundation for future open commerce. However, GATT needs to be broadened in scope and strengthened in enforcement. Those needs should be priority items—along with working on a code that encompasses the vast area of trade in services—to the next round of GATT multilaterial negotiations.

Expanded world trade, therefore, is often blunted by the actions of attitudes of nations that are inconsistent with America's way of conducting international business. Here I need only refer to: The "government mercantilism" that allows for rebates on value added taxes and other types of tax refunds; direct and indirect financial assistance to exporters; coproduction and other unreasonable demands on U.S. companies; the establishment of performance standards and other nontariff barriers—and yet many of our competitors have the effrontery to complain about our DISC program; and such restrictive practices as quotas, national preference in government procurement, arcane licensing procedures, non-compliance with reciprocal agreements, local content requirements and other technical requirements.

It is also time that nations develop a set of rules for international trade in services. Such trade accounts for about one-third of the Unites States' total exports and 65 percent of our GNP.

It is therefore imperative that nations extend to trade in services the principles of open and fair trade. Since trade in services has only recently started to attract the attention it deserves, let me cite a few of the problems American firms are encountering: Banks are prohibited from establishing branches in certain countries; insurance companies are denied licenses to offer their full range of services; and, airlines are discriminated against through excessive airport user charges—London's Heathrow is a good example of this- -inferior ground handling services and exclusion from travel agency reservation systems.

Quite simply, the existence of all these formal and informal barriers can distort our trade and investment programs by negating many of our gains in quality, productivity and price competitiveness. And, in the imperfect world we live in, the danger is greater today than at any time since World War II that protectionist measures will impede world trade.

Protectionism can provide short-term—and short-sighted—relief at the expense of long-term instability. I can't emphasize enough that, in the long run, protectionism helps no one, and that it will untimately harm everyone. The proper strategy is to meet protectionism's grim challenge by investing and innovating, by enhancing competitiveness, and by opening new markets. In short, what is best for America—and for our trading partners—is open and fair trade worldwide—with special emphasis on the word "fair." We want nothing more than to be able to compete on the basis of price, quality and service, and not on the level of which nations are providing subsidies to exporting industries and export credit subsidies to prospective customers.

I strongly agree with U.S. Trade Representative Bill Brock, who earlier this year said, "At no other time in our history has international trade, of necessity, so dominated our thinking . . . Economic interdependence is a fact or life. Exports have been doubled as a percentage of our gross national product in the last ten years, and we have been too slow to acknowledge that. Trade is our lifeblood."

This is a message that must be communicated throughout America. For any increase in our standard of living will require an increase in our economic growth, because one of the greatest opportunities we have to achieve economic growth is through the continued growth of our exports of goods and services to other nations.

Increased exports are critical to America's full economic recovery and continued well being. They are crucial to our efforts to reduce our substantial trade deficit and help pay for imported oil and other products which the American economy demands and American consumers desire. Now, as our national export policy is taking shape, the President's Export Council is in the unique position of having the opportunity to act as a catalyst for change, action and success.

The Council, better known as the PEC, is, at once, a grass roots organization and a presidential advisory group. It has traditionally worked closely with the District Export Councils which, of course, know much about the export-related needs and problems of small and medium-sized businesses. Yet, we intend to improve upon an already excellent relationship.

Its charter calls for it to give the President clear and concise recommendations on removing obstacles to trade expansion, and to identify mechanisms to take advantage of new export opportunities. The Council, which was formally reconstituted on October 15, consists of: twenty-eight private citizens who represent a wide spectrum of business and professional backgrounds; three U.S. Senators; three Congressmen; the Secretaries of Commerce, State, Treasury, Labor and Agriculture; the U.S. Special Trade Representative; and, the Chairman of the Export-Import Bank.

The Council is not one of those advisory groups that produces a lot of paper and then disappears. Whenever we have a recommendation to make—and I suspect it will be often—it will go directly to the President. And we are determined to contribute to the implementation process once our proposals are approved.

The Council has been effective. Of the 26 recommendations of the previous PEC, 15 have already been implemented, and the Reagan Administration is in the process of implementing 8 more. Only three have not been approved.

Our first order of business was to point out to the President the importance of passing legislation creating export trading companies to facilitate the entry of small and medium-sized companies into international markets. Following is a copy of the resolution sent to President Reagan on October 30, 1981:

THE PRESIDENT'S EXPORT COUNCIL,
Washington, D.C., October 30, 1981.

The PRESIDENT,
The White House,
Washington, D.C.

DEAR MR. PRESIDENT: On behalf of the President's Export Council, I submit herewith its resolution calling for prompt enactment of legislation to facilitate the formation and operation of export trading companies:

The President's Export Council, as its first order of business, agreed to advise you that the establishment of the export trading company concept should be your top priority in the international trade area.

Export trading companies are necessary in order to realize economies of scale and to provide small firms with access to the expertise so often critical to successful international competition. Formation of such companies should provide a major step in the economic recovery of the nation. They would contribute to the reduction of the nation's trade deficit by fostering the growth of exports, which already contribute approximately 20,000 jobs for every one billion dollars in sales.

We recognize that the Administration has already endorsed the export trading company concept, but call your attention to the fact that immediate action in the House of Representatives is necessary if legislation is to pass this year. We urge the Administration to intensify discussions with the appropriate committees in the House, particularly the Judiciary Committee, in order to work toward speedy passage of export trading company legislation.

We hope you will give our views close attention, as this is one of the most practical ways in which the United States can increase exports.

Sincerely,

J. PAUL LYET, *Chairman.*

Our recommendation was not just an endorsement, but an urging to work immediately with key House committee chairmen to achieve a bill during the current session that is compatible with the legislation that was passed 93-0 by the Senate earlier this year.

The PEC is set up to work through six subcommittees: Incentives and Disincentives; Export Promotion; Agriculture; Export Administration; District Export Councils; and, Trade in Services.

Following, for the record, is the working list of issues for the six subcommittees;

DISTRICT EXPORT COUNCIL/INDUSTRY SECTOR ADVISORY COMMITTEE LIAISON SUBCOMMITTEE

Develop liaison with the District Export Council (DECs); establish mechanism for ensuring that DECs' concerns are brought to the attention of the PEC and that the PEC obtains DEC advice on key issues addressed by other PEC Subcommittees.

(a) Identify persons from each of the DECs or from the nine regional managing directors' councils to act as liaison with this subcommittee

(b) Invite DEC representatives to speak at subcommittee and Council meetings

(c) have PEC members made "ex-officio" members of their local DECs; have PEC members speak at DEC meetings and participate in key local activities

(d) Utilize the DECs in promoting business community understanding of and support for major PEC concerns or trade initiatives (i.e, export trading companies)

(e) Establish means of automatically canvassing DECs on their views on issues under consideration by the Council

(f) Make suggestions to DECs on promotional activities that could be undertaken locally

Develop liaison with Industry Sector Advisory Committees (ISACs); establish mechanism for ensuring that ISAC concerns are brought to the attention of the PEC and that the PEC obtains advice on issues from the relevant ISACs.

(a) Ensure that services industry ISAC and Export Administration ISACs have direct link with the complementary PEC subcommittees.

(b) Have presentation on ISAC structure at early meeting.

(c) Invite ISAC members to attend this or other subcommittee meetings to address topics of mutual concern.

(d) Establish liaison with USTR's Advisory Committee on Trade Negotiations.

(e) Identify persons from key ISACs to act as liaison with PEC on ISAC recommendations and concerns.

(f) Establish means of automatically canvassing relevant ISACs on key issues

Develop liaison with other private sector organizations to coordinate activities.

(a) Business Roundtable.

(b) U.S. Chamber of Commerce.

(c) National Association of Manufacturers.

(d) Labor-Industry Coalition for International Trade.

(e) Emergency Committee on America Trade.

(f) Other key trade organizations.

Review federal and state government programs that provide information and assistance to exporters and relative roles of each

(a) Review possible joint Commerce/State-government information services initiatives

(b) National Governors' Association initiatives

EXPORT ADMINISTRATION SUBCOMMITTEE

This subcommittee already has a charter. Duties include:

Advising "on matters pertinent to those portions of the Export Administration Act of 1979 that deal with U.S. policies of encouraging trade with all countries with which the U.S. has diplomatic or trading relations, and of controlling trade for national security, foreign policy and short supply reasons".

"Provide advice and make recommendations on ways to minimize the adverse impact of export controls on U.S. business".

As a start, subcommittee could follow-up on previous PEC recommendations concerning the relaxation of controls over re-export of COCOM-controlled items and relaxation of controls on exports to countries that cooperate most closely with the U.S. Also, the committee should review export licensing procedures in an effort to expedite the licensing process. The subcommittee should coordinate with the technical advisory committees that are concerned with export control issues.

The subcommittee also should include on its agenda consideration of East-West Trade policies and programs and the promotion of defense-related exports.

EXPORT PROMOTION SUBCOMMITTEE

Review how the PEC can contribute to the enactment process of Export Trading Company (ETC) legislation and how it can encourage effective use of ETCs by business

Review disincentives to U.S. technological development and productivity that affect our competitiveness abroad, including domestic regulation; possible presentation by the CIA at an early meeting

Focus on how to take advantage of market opportunities; how to capitalize on U.S. superiority in certain goods and how to promote such goods abroad

Provide recommendations in support of the National Coal Export Policy

Focus on regional/bilateral issues and opportunities; consider sub-groups with geographic focus to:

(a) Identify countries/regions with which the U.S. has close bilateral ties and foreign policy interests but has a trade deficit (e.g., ASEAN, Nigeria); consider ways of using this leverage to increase exports

(b) Consider trade with Mexico and issues relating to U.S. market access and industry pursuit of opportunities provided by government-to-government negotiations

(c) Consider trade with Japan and issues relating to U.S. market accesss and industry pursuit of opportunities provided by government-to-government negotiations

(d) Consider ways to expand trade with the Caribbean Basin

Investigate need for automating/upgrading U.S. export information services and review foreign government information systems for ideas; consider how to focus and coordinate private sector information services to support exporters.

Review Foreign Commercial Service programs and ways to make our embassies more responsive to U.S. exporters' needs; assist in recruitment efforts for new FCS officers

Consider ways to promote exporting among small and medium-sized U.S. firms

Review possibility of a private sector initiative of a communications nature to support the export promotion goals of the Administration

Review need for and nature of a national export goal and means of achieving private sector participation and leadership in meeting such a goal

AGRICULTURE SUBCOMMITTEE

Review ways to ensure adequate financing for agricultural exports; follow-up on previous PEC recommendation on establishing the Commodity Credit Corporation on a revolving fund basis

Review ways to reduce agricultural market access problems:

(a) Ensuring full utilization of levy-free quotas and zero bindings (no tariff) on agricultural commodities, as negotiataed in Tokyo Round

(b) Reviewing EC use of subsidy programs for exporting agricultural commodities that tend to neutralize Tokyo Round progress

(c) Continuing to work with the Japanese to expand their imports of citrus and beef

Review areas for cooperation between, or integration of, USDA and Commerce information services

Coordinate with Agricultural Council of America on their new trade promotion program

Review other issues to ensure continued healthy exports of agricultural commodities

INCENTIVES AND DISINCENTIVES SUBCOMMITTEE

Review and make recommendations on regulations concerning types of foreign taxes that can be credited against US. income tax liability as income taxes or "taxes in lieu of income taxes". (Temporary regulations issued by Treasury in November 1980 have created uncertainty within the business community and impede tax planning for international operations. The IRS Commissioner has said that the Administration will review the regulations, but we have no timetable for Treasury action.)

Consider possible substitutes for the DISC, since the DISC may be found to be a prohibited subsidy under the Generalized Agreement on Tariff and Trade (GATT). The District Export Councils have already done some work in this area, and USTR and Treasury are currently studying the issue in anticipation that, in October, the DISC may come before the GATT Council.

Review U.S. Government export financing programs and operations; suggest strategies for Eximbank to make the best use of scarce resources (e.g., country or industry targets); consider what U.S. Government actions should be taken, bilaterally or unilaterally, to reduce foreign export credit subsidies should current negotiations on export credit guidelines prove unsuccessful.

Follow-up on previous PEC recommendations concerning clarifying the Foreign Corrupt Practices Act. Review Senator Chafee's proposed amendments, S. 708, and the Administration's suggested approach to the accounting provisions.

Follow-up on previous PEC recommendation concerning harmonizing anti-boycott regulations.

Review current regulations concerning the export of hazardous substances. Six different statutes administered by several agencies now apply, and the U.S. lacks a clear policy on this issue. The restrictions place U.S. firms at a competitive disadvantage and cause uncertainty because of inconsistent requirements.

Consider Generalized System of Preferences policy, and follow-up on previous PEC concerns regarding "graduation" of LDC's; are "bunched" GSP benefits creating unfair competition for our own industries?

Explore trade-related investment policies of foreign countries that adversly affect U.S. exports, such as performance requirements, Canada's National Energy Program, Mexico's Automotive Decreee, etc. Consider how U.S. should respond and contribute to review and revision of U.S. Investment Policy Statement.

Follow-up on previous PEC concerns regarding application of U.S. antitrust laws overseas.

Review and make recommendations on reducing other disincentives to exporting.

Consider what incentives the U.S. Government might provide to the private sector to make exporting operations a more attractive option in corporate planning.

TRADE IN SERVICES SUBCOMMITTEE

Review Senator Inouye's bill, the Services Industry Development Act, for possible endorsement.

Coordinate with the Services ISAC and USTR's Services Policy Advisory Committee (chaired by James Robinson, Chairman of the Board of American Express).

Review U.S. Government trade facilitation programs for services.

Identify barriers to services trade in specific key countries, focusing on areas of the world where service industries have high market potential.

Foster business/government cooperation in services data improvement.

Review government plans for international trade negotiations on services.

Review problems with transborder data flow and offer recommendations.

Review the impact of U.S. aviation and maritime policy on U.S. exports, tourism and overseas earnings.

Review AID eligibility requirements for contractors. AID currently allows advanced developing countries to supply services on projects abroad; this is of particular concern to the construction industry.

Consider possible U.S. Government mechanisms for facilitating engineering and construction services exports; consider possible programs for financing architectual and engineering exports.

Review impact on services exports of problems with distinction between what is considered U.S.-sourced income and what is considered foreign-sourced income for purposes of obtaining foreign tax credits; this problem is particularly acute for service industries, i.e., construction, technical consulting and companies involved in transborder data flows.

Make recommendations on other ways to promote services sector exports, including review of other domestic disincentives.

While the six subcommittees are focusing on a wide range of specific issues, the overall thrust of the Council's job is to relate many diverse areas to four key elements in our export strategy:

First, we must eliminate our export disincentives and focus on incentives.

Second, we must develop better ways to promote exports. Foremost here is the need to make even better use of the grass roots District Export Councils.

Third, we must encourage many more companies to export. Of the 250,000 U.S. manufacturing companies, only 10 percent export, and only 100 companies account for half of all our manufactured goods. We must work with these companies and must also broaden our export base to include other firms that may be highly competitive but have not even considered marketing their products abroad. Here, again, I cannot reiterate strongly enough the need for passage of export trading company legislation during this session of Congress.

Fourth, we must devote all the needed energy and resources to establish a system of rules for world trade. We must enforce and perfect the rules now in place and encourage more nations to accept the spirit and intent of the multilateral trade agreements. Earlier this year, the Administration presented to Congress a White Paper on trade that went to the heart of the matter of international competitiveness. It said American industry will have to either upgrade its capabilities or, where it is evident that other countries have a "natural competitive advantage," move on to other activities. The operative word here is "natural," because the statement put our trading partners on notice that Washington will strictly enforce all U.S. legislation against dumping, subsidies, and other similar practices that can distort trade patterns.

International competitiveness, then, is crucial to our economic revitalization. It must become a national priority. For such a goal to be realized, the United States needs an aggressive export strategy that coincides with the implementation of an industrial strategy for economic revitalization.

The Economic Recovery Act of 1981 is an essential first step in the right direction because it has the potential to reduce inflation and facilitate greater productivity. Business must aggressively take advantage of its new provisions on accelerated depreciation, extension of its investment tax credit, reduced tax burdens for Americans working abroad and research and development incentives.

Hopefully, the euphoria surrounding the Act's passage will affect a mood of optimism that will help us turn away from our preoccupation with short-term results, and let us develop a long-term perspective based on risk, innovation and an abiding concern with higher productivity and higher quality products. But the Act's success in contributing to expanded trade could easily by blunted by actions and attitudes of our trading competitors that are inconsistent with our way of conducting international business.

Thank you very much, Mr. Chairman, for giving me the opportunity to discuss Sperry Corporation's international activities, and to familiarize the Subcommittee on the role and plans of what I hope will be an activist President's Export Council.

WESTERN UNITED STATES CHEESE IMPORTERS ASSOCIATION,
San Francisco, Calif., March 15, 1982.

DAVID ROHR,
Staff Director, Subcommittee on Trade,
Cannon House Office Building, Washington, D.C.

DEAR MR. ROHR: We regret that our representatives are unable to attend the Subcommittee's hearing scheduled for March 18, 1982.

However, for the record we offer the following statement:

"The Western United States Cheese Importers Association is newly formed. It consists mainly of Cheese Importers who possess little license to import cheese into the United States. Most of our members have their principle place of business on the Pacific Coast.

Our members wish to call the attention of this Subcommittee to the recent publication by the United States Department of Agriculture (FAS) entitled "Changes in Licensing For Certain Dairy Imports" (July 1981). This report provides an excellent overview of the quota and licensing system now in effect, including statistics on total quotas and the manner in which licenses have been allocated during the last 30 years. The statistics clearly show that most new entrants in the cheese importing business have relatively very small licenses and little prospect for increasing the size of their allocated shares of the quotas.

Our Association believes the entire quota and licensing system should be reviewed with a view towards devising a program which will protect our domestic dairy producers and at the same time not adversely affect the cheese importers. Representatives of the USDA (FAS) have challenged our Association to come up with such a program. Our representatives are in the process of doing just that. Our members are large users of domestic cheese products. They are particularly sensitive to the needs of our domestic producers. We plan to propose a new program which is acceptable to both groups. However, in our judgment, we estimate it will take at least a year before our ideas can be worked out and reviewed with representatives of the dairy industry. We also plan to discuss our proposal with major cheese importers and representatives of the Cheese Importers Association.

In the meantime our Association recommends the following:

1. Retain the preferred importer provisions. Not all foreign governments establish dummy partners in the U.S. for importing their cheese. For example, Switzerland designates American importers. Many of our members have received substantial increases in their Switzerland cheese licenses. When domestic importers controlled by foreign interests are designated as preferred importers the advantage of holding such licenses, as far as American controlled companies are concerned, is nullified for economic purposes. This is because all American distributors must buy the cheese at the same price level from the foreign producer's nominee.

2. The price—undercutting should also be retained. These provisions were placed in the regulations to protect our domestic dairy producers. It will be difficult to change the quota system if the domestic dairy producers continue to believe importers desire to weaken or threaten the domestic dairy industry. Our new program contemplates that the Secretary should retain the authority to deal effectively with price undercutting.

3. Finally, there has been discussion concerning approximately 2,000 tons of quota which has never been allocated to importers. There has also been discussion concerning the desirability of increasing the total quotas. Our members recommend that any additional or new licenses derived from the unassigned 2,000 tons of quota and any increase in existing quotas be allocated to those licensees having the relatively small licenses. The method for allocating such licenses must require the USDA to take the relative size of existing licenses into consideration in order to make a fair allocation of such quotas."

Thank you again for the invitation to appear. We request the name of our organization be retained by the staff for invitation to future hearings on the subject.

Respectfully submitted,

DONALD INGOGLIA.

WISCONSIN CHEESE MAKERS ASSOCIATION,
Madison Wis., December 28, 1981.

Subject: Cheese imports.

Hon. SAM M. GIBBONS,
Chairman, Subcommittee on Trade, Committee on Ways and Means, House of Representatives, Washington, D.C.

DEAR MR. GIBBONS: It is my understanding that your sub-committee is conducting hearings regarding United States Import Policy. I assume that part of these hearings has to do with cheese imports.

Therefore, enclosed please find a letter the Wisconsin Cheese Maker's Association recently sent to Secretary of Agriculture John Block requesting that he ask President Reagan to order a Section 22 investigation into cheese imports.

I believe the letter is very self explanatory and fairly well outlines the situation this nation's Dairy Industry is in and the impact that cheese imports are having on that situation.

I would hope that this letter would become part of the record of your hearings into Import Policy.

In addition, I would be interested in being advised of when the portion of the hearings having to do with dairy imports is scheduled for and whether or not representatives of the nation's Dairy Industry will be given an opportunity to testify at that time.

I look forward to your response at your earliest possible convenience.

Sincerely,

JAMES E. TILLISON,
Executive Director.

Enclosure.

WISCONSIN CHEESE MAKERS ASSOCIATION,
Madison, Wis., December 21, 1981.

Subject: Cheese imports.

Secretary JOHN BLOCK,
U.S. Department of Agriculture,
Washington, D.C.

DEAR SIR: On behalf of the cheese industry of the United States, the Wisconsin Cheese Makers' Association respectfully requests that you ask the President of the United States to order an investigation of cheese imports as provided under Section 22 of the Agriculture Adjustment Act of 1933.

The basis of this request is, of course, that cheese (and other dairy products) imported into this country are displacing significant quantities of domestic products so as to "tend to render" the Dairy Support Program ineffective and "reduce substantially the amount of product processed in the United States . . ."

This is especially true given the most recent Farm Bill passed by the Congress and signed into law by the President. The new Dairy Support provisions are based on adjustments to the support price being triggered by the dollar amount spent *and* the milk equivalent poundage purchased by the Commodity Credit Corporation.

Import quotas for cheese in 1981 are set at approximately 238 million pounds, or in milk equivalent terms, over 2 billion pounds. Since the Farm Bill has set a maximum purchases figure on a milk equivalent basis for 1982 of 4 billion pounds, 3.5 billion pounds in 1983 and 2.69 billion pounds in 1984 as the trigger levels for adjustments to the support program, over 2 billion pounds milk equivalent of cheese imports most certainly will tend to render the Dairy Support Program ineffective.

A number of factors effect the production of milk in this country, one of which is the support program. The Administration's new Farm Bill ties the support price directly to government purchases of product for the first time. It appears to be very counter-productive to the aims of the new Farm Bill, and a real disservice to the American taxpayers and the dairy industry, to continue to allow such high import levels to remain untouched.

Therefore, you most certainly must believe that cheese imports do materially interfere, tend to render ineffective, and do substantially reduce domestic production so as to negatively effect the dairy support program. And, you then must request the President to order an immediate Section 22 investigation.

The entire dairy industry, the United States cheese industry and the taxpayers of America await your affirmative decision and response.

Sincerely,

JAMES E. TILLISON,
Executive Director.

WISCONSIN CHEESE MAKERS ASSOCIATION,
Madison Wis., January 22, 1982.

Representative SAM M. GIBBONS,
Chairman, Subcommittee on Trade, Committee on Ways and Means, House of Representatives, Washington, D.C.

DEAR REPRESENTATIVE GIBBONS: Thank you for your letter of January 13th regarding the Trade Sub-Committee's oversight hearings.

The only other thought that I would like read into the record or made part of the permanent record of the committee's hearings is the following:

Contrary to what representatives of importers may say, in requesting a Section 22 investigation into cheese imports, the cheese industry is not blaming imports totally for the present dairy surplus situation. However, imports do affect the levels of government purchases by displacing domestic production. Therefore, to increase import quotas for cheese, or at this point to even allow them to remain at present levels, is having and will continue to have a negative effect on the Dairy Support Program. At this point in time the Wisconsin Cheese Makers' Association is not concerned about why the CCC inventories are at such high levels, but rather how the situation can be gotten under control and in balance in the shortest period of time. Reducing imports will certainly be a tremendous help in obtaining the Administration's Dairy Support Program levels.

Again, thank you for putting my first letter to Secretary of Agriculture Block into the record of your hearings, and I hope this letter with the comment above will also become part of the record.

Best regards,

James E. Tillison,
Executive Director.

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